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CONTROL OF BANK HOLDING COMPANIES

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Mr. ROBERTSON, from the Committee on Banking and Currency, reported the following additional amendments to accompany the bill S. 2577, heretofore reported

The Committee on Banking and Currency, having heretofore considered and reported the bill (S. 2577) to define bank holding companies, control their future expansion, and require divestment of their nonbanking interests, hereby report certain additional amendments, with an accompanying report, and recommend their adoption.

On July 25, 1955, the committee reported the bill (S. 2577) to define bank holding companies, control their future expansion, and require divestment of their nonbanking interests. Since the bill was reported out during the closing days of the 1st session of the 84th Congress, it was understood that the bill would not be acted upon by the Senate until the 2d session of the 84th Congress. The interim period provided an opportunity for the Members of the Senate, representatives of bank holding companies, and other interested persons to study the proposed legislation and determine if any perfecting amendments were necessary. As a result of the study, the committee has agreed to a number of technical and clarifying amendments and amendments to the tax provisions of the bill.

NONTAX AMENDMENTS

The committee wishes to emphasize that these amendments do not in any way change the principal objectives of this proposed legislation. These objectives are: (1) To regulate the future expansion of bank holding companies, and (2) to require bank holding companies to divest their nonbanking investments. The amendments are designed to correct technical errors in the bill and to clarify the language of several provisions so that any possible misinterpretation of the committee's intent can be avoided.

CHANGE OF DATE

The bill as reported by the committee bears the short title of "Bank Holding Company Act of 1955." Since the bill will be scheduled for enactment during 1956, it is necessary to change "1955" to

"1956" in the short title wherever it appears in the bill. This is accomplished by striking "1955" and inserting "1956" on page 1, line 4, and page 14, line 23, in the substantive sections of the bill. The tax amendments make the necessary date changes in the tax provisions.

SHAREHOLDERS OR MEMBERS

On page 5, line 9, of the bill as reported by the committee, a reference is made to shares held by trustees for the benefit of the "shareholders and members" of a bank holding company. The "and" is a typographical error and should read "or." This change makes the provision conform to the language on page 2, line 3, where reference is also made to "shareholders or members."

ACQUISITION SHARES IN A FIDUCIARY CAPACITY

Section 3 (a) of the bill requires prior approval by the Federal Reserve Board before any action may be taken which results in a company (including a bank) becoming a bank holding company. The bill as reported provided an exemption from this requirement for a bank which is a bank holding company in cases where the shares were acquired (i) in good faith in a fiduciary capacity or (ii) in the regular course of securing or collecting a debt. This language would seem to preclude a bank which is not a bank holding company from acquiring such shares in other banks or in bank holding companies without prior approval by the Board. It was not the intent of the committee to require approval by the Board where a bank acquired shares in a fiduciary capacity or in the regular course of securing or collecting a debt. In order to clarify the language of the exemption, the committee struck the works "which is a bank holding company" on lines 4 and 5 of page 6. Thus, the amendment exempts from the prohibition of section 3 (a)—

shares acquired by a bank (i) in good faith in a fiduciary capacity, except where such shares are held for the benefit of the shareholders of such bank, or (ii) in the regular course of securing or collecting a debt previously contracted in good faith but any shares acquired after the date of enactment of this Act in securing or collecting any such previously contracted debt shall be disposed of within a period of 2 years from the date on which they were acquired;.

SHARES IN A BANK HOLDING COMPANY

Section 4 (a) (2) of the bill as reported provides in part that no bank holding company shall, after the date of enactment of the act, "retain direct or indirect ownership or control of any voting shares of any company which is not a bank." This language would prohibit a bank holding company from holding shares in a subsidiary bank holding company. This result was not intended, since it is a common practice for bank holding companies to hold a part or all of their banking investments in a subsidiary corporation. In order to remedy this situation, line 17 on page 8 was amended by adding after the word "bank" the words "or a bank holding company." Thus, this section as amended provides that no bank holding company shall after the date of enactment of the act—

retain direct or indirect ownership or control of any voting shares of any company which is not a bank or a bank holding company.

SUBSIDIARY SERVICE COMPANIES

Section 4 (c) provides certain exemptions from the divestment requirements of the bill. Subparagraph (1) of section 4 (c), as reported by the committee, exempts companies engaged in serving the bank holding company and its subsidiary banks in "auditing, appraising, investment counseling." Your committee has found this provision too restrictive as there are many other legitimate types of servicing which should be permitted. Other services rendered by subsidiary companies are in the fields of advertising, public relations, developing new business, organization, operations, preparing tax returns, personnel, and many others.

In order to properly encompass this wide range of activities, your committee amended subparagraph (1) to exempt such companies solely engaged in "furnishing services to or performing services for" the bank holding company and its banking subsidiaries. Thus, the bill, as amended, would permit a bank holding company to furnish these services to its subsidiaries through a subsidiary company as well as directly by the holding company itself as provided in section 4 (a) (2).

This provision is not intended to supplant the exemption contained under section 4 (c) (6), where the Federal Reserve Board is given discretion to exempt activities of a "financial, fiduciary, or insurance nature" which are so closely related to banking as to be a proper incident thereto. Such financial, fiduciary, or insurance activities do not come within the scope of the meaning of the phrase "furnishing services to or performing services for a bank holding company." The servicing exemption should not be interpreted to include activities beyond the ordinary category of such services.

SHARES ACQUIRED IN SATISFACTION OF A DEBT

Section 4 (c) (2) of the bill as reported provides an exemption from the divestment requirements for shares acquired by a bank holding company which is a bank or "any of its banking subsidiaries" in satisfaction of a debt previously contracted in good faith. A literal reading of this language would seem to provide an exemption only for banking subsidiaries of a bank holding company which is a bank. It was intended that the exemption would apply to banking subsidiaries of any bank holding company. This provision was clarified by amending line 4 on page 10 by striking the words "any of its banking subsidiaries" and inserting in lieu thereof "by any banking subsidiary of a bank holding company." Thus, a banking subsidiary of any bank holding company could qualify under this exemption.

SHARES ACQUIRED IN A FIDUCIARY CAPACITY

Section 4 (c) (4) of the bill as reported provides an exemption from the divestment requirements of the bill for shares which are held or acquired by a bank which is a bank holding company in a fiduciary capacity. This language would not permit a banking subsidiary of a bank holding company to qualify under this exemption. Lines 19 and 20 on page 10 were amended by striking the words "which is a bank holding company in a fiduciary capacity" and inserting in lieu thereof—

holding company which is a bank or by any banking subsidiary of a bank holding company, in good faith in a fiduciary capacity, except where such shares are held for the benefit of the shareholders such bank holding company or any of its subsidiaries.

Thus the exemption applies both to a bank holding company which is a bank and to a banking subsidiary of any bank holding company with the limitation that such shares cannot be held for the benefit of the shareholders of such bank holding company or any of its subsidiaries.

OWNERSHIP AND ACQUISITION OF SHARES

Section 4 (c) (5) of the bill as reported provides an exemption from the divestment requirements for the ownership by a bank holding company of up to 5 percent of the shares of any company. This section does not refer to the acquisition of shares as is set forth in other exemptions under section 4 (c). Because of the shift in language, it could be argued that this exemption does not apply to the acquisition of shares but only to the retention of shares already owned. To clarify the situation, lines 24 and 25 on page 10 were amended by striking the words "to the ownership by a bank holding company of shares of any company" and by inserting in lieu thereof "to shares of any company which are held or acquired by a bank holding company." This amendment makes it clear that the exemption applies to both the acquisition and ownership of such shares.

LABOR, AGRICULTURAL OR HORTICULTURAL ORGANIZATIONS

Section 4 (c) (7) of the bill as reported contains an exemption from the divestment requirements for any bank holding company which is a labor, agricultural or horticultural organization. Although the committee report points out that in order to be entitled to this exemption no net income derived by any such organization can inure to the benefit of any individual, this limitation is not set forth in the language of the subsection. The intention of the committee is made explicit by inserting at the end of the subsection on line 15, page 11, the words "and which is exempt from taxation under section 501 of the Internal Revenue Code of 1954."

FOREIGN BANKING SUBSIDIARIES

Section 2 (c) of the bill as reported defines "bank" so as to exclude any organization which does not do business within the United States. Thus, technically any foreign banking subsidiary of a bank holding company would be a nonbanking investment and would be required to be divested pursuant to section 4 (a) of the bill. The Federal Reserve Board would probably exempt such foreign banking subsidiaries from divestment by applying the provisions of section 4 (c) (6), which authorizes the Board to exempt companies of a financial nature which are so closely related to the business of banking as to be a proper incident thereto.

However, in order to make it unmistakably clear that foreign banking subsidiaries are not subject to divestment, the committee added a new subparagraph (8) to section 4 (c) specifically exempting such subsidiaries. The amendment provides that the divestment requirements shall not apply—

to shares held or acquired by a bank holding company in any company which is organized under the laws of a foreign country and which is engaged principally in the banking business outside the United States.

ADMINISTRATION

The committee agreed in reporting out the bill that section 5 (a) contain the same language as set forth in section 4 (a) of H. R. 6227 in regard to the information required by a bank holding company in registering with the Federal Reserve Board. However, through inadvertence, improper language was inserted on lines 22 through 25 on page 11. This was corrected by striking the words beginning with "history" on line 22 through to the word "organizations" on line 25 and inserting in lieu thereof—

condition and operations, management, and intercompany relationships of the bank holding company and its subsidiaries,.

RESERVATION OF STATES RIGHTS

A great deal of concern has been expressed that section 7 of the bill as reported by the committee granted new authority and powers to States over national banks in general, and respecting the stocks of national banks in particular. This concern apparently has arisen as a result of the language added to this section by the committee and certain statements which appeared in the committee report. The language added by the committee in the bill as reported provided that States in the exercise of their jurisdiction and powers over banks and bank holding companies could impose "no less onerous" restrictions than were provided in the bill. The intent of the committee was to make it clear that a State could not enact legislation inconsistent with the bill and therefore nullify its effect. In view of the fact that the meaning of the no less onerous clause has apparently been misconstrued by some persons, the committee agreed to strike the clause and thus return to the language of the comparable section of H. R. 6227. However, your committee reiterates its view that section 7 in no way permits States to exercise such powers and jurisdiction in a manner inconsistent with this proposed legislation.

In order to clarify the legislative history of section 7, the committee wishes to emphasize that this section does not grant any new authority to States over national banks. The purpose of the section is to preserve to the States those powers which they now have in our dual banking system. It is always of uppermost importance in legislation of this nature to preserve the dual system of National and State banks, and section 7 must be viewed in that light.

TIME LIMIT ON JUDICIAL REVIEW

Section 9 of the bill as reported by the committee contained no limit on the time within which an aggrieved party must seek judicial review of an order of the Federal Reserve Board. A time limit is necessary so that persons or companies affected by the Board's orders may know when they may act in reliance thereon without fear of the orders being subsequently set aside or modified by court decree. The committee amended this section by providing that any aggrieved party seeking judicial review must do so within "60 days after entry of the Board's order."

TAX AMENDMENTS

General Explanation

H. R. 6227, passed by the House of Representatives, would add a new part VIII to subchapter O of the Internal Revenue Code of 1954. Under this new part, several tax-free paths are provided for the divestment of property which this bill imposes on a bank holding company. S. 2577, as originally reported, adopted the tax provisions of the House bill with certain technical changes. Your committee's additional amendments modify these tax provisions so as to prevent abuse and to make them more flexible to meet legitimate business needs by alining them closer to similar provisions in the Internal Revenue Code of 1954.

In general, a corporation which comes within the terms of the bill as a bank holding company can choose between remaining a bank holding company or disposing of its interests in banks. The tax provisions of the bill apply only to a corporation which would have been a bank holding company on May 15, 1955, and which on that date held prohibited property.

If a corporation decides to remain a bank holding company, subject to the supervision of the Federal Reserve Board, it may distribute any prohibited property, which the Board certifies is necessary or appropriate to comply with the bill, to its shareholders without the recognition of gain by the shareholders. For this purpose prohibited property, in general, means stock or assets of nonbanking businesses to the extent the bank holding company is required to divest itself of such assets under section 4 of the bill. The term does not include cash, Government bonds, or certain short-term obligations. It is believed desirable to expressly exclude cash, and so forth, from the definition of prohibited property, since a similar exclusion is contained in the comparable provisions of part VI of subchapter O, relating to exchanges in obedience to SEC orders.

With respect to the distributing corporation, the usual provisions of the Internal Revenue Code of 1954 apply. Under these provisions, gain generally is not recognized to the distributing corporation except under unusual circumstances such as the distribution of LIFO inventory, the distribution of property subject to a liability in excess of the adjusted basis, or the distribution of certain installment obligations.

The distribution of prohibited property may be made either directly to the shareholders of the corporation which is a bank holding company or may be transferred to a wholly owned subsidiary expressly created for purposes of receiving the prohibited property, in which case all of the shares in the new corporation must be distributed directly to shareholders. Under the bill prohibited property may be placed in one or more such new corporations. Your committee's amendments differ from S. 2577, as originally reported, by providing that other assets may also be transferred to a new corporation without making the transaction taxable. This would include cash and bonds, for working capital purposes, as well as prohibited property acquired after May 15, 1955, but not controlling shares of bank stock or similar property.

Your committee's amendments also differ from S. 2577, as originally reported, by providing that the tax exemption for any particular distribution may be denied if that distribution is part of a plan with a principal purpose of avoiding dividend tax on a distribution of earnings and profits.

Your committee's amendments also differ from S. 2577, as originally reported, by making provisions for certain exchanges of stocks and bonds as part of the divestment program. Under S. 2577, as originally reported, bank holding companies having outstanding preferred stocks and bonds might encounter serious obstacles in making use of the tax provisions of the bill. The divestments required under the general provisions of the bill would remove from the corporation property that provides security for its preferred stocks or bonds. Your committee's amendments would permit the exchange of preferred stocks and bonds in the old corporation for comparable securities in the new corporations or direct distribution of prohibited property in exchange for the outstanding preferred stocks or bonds.

The bill provides that in exchanges involving the creation of a subsidiary a common shareholder may only receive common stock, a preferred shareholder may only receive preferred stock issued on substantially the same terms or common stock, and, finally, a bondholder may receive only bonds issued on substantially the same terms, or preferred or common stock. It is also provided that a bondholder in such an exchange may be taxable on any greater face value of bonds received over those given up.

If a corporation which is a qualified bank holding company under the bill chooses to divest itself of all or part of any stock or property which causes it to be a bank holding company, it may distribute directly to its shareholders or bondholders such stock or property, or it may form a subsidiary to effectuate such distribution. Your committee has made the same revisions for divestments of this type as are made in the case of divestments of prohibited property.

The Board must certify that the divestment of the bank stock or similar property is necessary or appropriate to effectuate the policies of the bill. In the case of direct distributions, for example, the corporation may distribute to its shareholders without the recognition of gain all the shares of bank stock in a bank in which it was deemed to have control within the meaning of section 2 (a) of the bill. Thus, if a corporation owned 40 percent of the voting stock of each of two banks, it could distribute all of its shares in those banks even though it ceased to be a bank holding company by distributing only 16 percent of the voting shares in one bank. If the same corporation had in addition 15 percent of the voting shares of a third bank, it would not be able to distribute tax free, under this bill, those voting shares unless the Federal Reserve Board deemed that by virtue of those shares the corporation exercised an effective control over the election of a majority of the board of directors of the particular bank.

Your committee contemplates that the Federal Reserve Board, in the discharge of its functions in making certifications that exchanges and distributions are necessary or appropriate to effectuate the purposes of the bill, will examine these from the point of view of their desirability from a banking standpoint. However, a certification by the Board that a particular divestment is necessary or appropriate is not to be considered as permitting any method of carrying out this

divestment if it is part of a plan having a principal purpose of avoiding dividend tax on a distribution of earnings and profits.

In case of direct distributions to stockholders and bondholders of either prohibited property or property which causes the distributing corporation to be a bank holding company, your committee has restricted the nonrecognition treatment to property which was owned on May 15, 1955. This restriction is deemed necessary to prevent corporations from purchasing highly marketable shares and other property as a means of transferring cash from the corporation to its shareholders. The restriction would not apply, however, if the property were received in a transaction in which gain was not recognized because of either the general rules described above or in certain types of corporate reorganizations or liquidations. For example, if prohibited property originally acquired prior to May 15, 1955, were distributed by a subsidiary to its parent in a corporate chain without recognition of gain to the parent by reason of provisions in this bill, the parent, in turn, may distribute the property to its own shareholders without recognition of gain under a certification by the Board, even though the property was acquired by the parent after May 15, 1955. Similarly, the May 15, 1955, cutoff date is not applicable where the prohibited property or controlling bank interests certified by the Board are retained at the corporate level by the transfer to a wholly owned subsidiary created for that purpose if stock of the subsidiary is distributed by the qualified bank holding company, and such distribution meets the tax avoidance test discussed previously. In the case of the creation of a subsidiary, prohibited property or controlling bank stock acquired after May 15, 1955, may be transferred to it along with prohibited property or controlling bank stock acquired prior to May 15, 1955.

In the case of a contribution to capital of any corporation made by a bank holding company after the date of enactment of this bill, the general test of a principal purpose of tax avoidance will be applied. Where a contribution has been made after May 15, 1955, and before the date of enactment under the terms described in the bill, the treatment provided in S. 2577, as originally reported, will be retained. If any part of the contribution made in this period is part of a plan for the avoidance of taxes, only a portion of the shares of the corporation to which the contribution is made will be taxable on distribution. This portion will correspond to the portion of the value of those shares attributable to the contribution.

Where the nonrecognition treatment has been extended to prohibited property which has been distributed by the corporation which is a bank-holding company, a final certification must be obtained from the Board that the corporation has divested itself of all property necessary or appropriate to comply with the bill within the statutory period permitted for divestment. If this final certification is not obtained, the transactions previously permitted to be made without recognition of gain are reopened and tax may be imposed in such cases. For this purpose the statute of limitations on assessment of deficiency resulting solely from the distribution of prohibited property which has been certified by the Board does not expire until 5 years after the corporation gives notification that the period prescribed in section 4 (a) of the bill has expired.

A similar final certification is required where nonrecognition treatment has been originally accorded to the distribution of bank stock or

similar property which the Board has certified that the corporation must divest in order to cease being a bank-holding company. In this case the tax provisions of the bill provide that the Board must give a final certification that the corporation has ceased to be a bank-holding company within 2 years after the date of enactment of the bill or within 2 years after the date on which the corporation becomes a bank-holding company, whichever is later, unless the time has been extended by the Board for 1-year renewals not to exceed 5 years from the date of enactment of the bill or the date on which the corporation becomes a bank-holding company, whichever is later. The statutory period for the assessment of a deficiency resulting solely from such distribution is extended in the same manner as in the case of the distribution of prohibited property.

The basis of stock or other property received by a distributee without recognition of gain under the provisions of the bill is determined by allocating the adjusted basis of the stock with respect to which the distribution is made between such stock and the property so distributed. In the case of any recognition of gain upon the receipt of stock or property, such gain will be taken into account in determining the adjusted basis of the stock with respect to which the distribution was made and the property which was received. These rules are similar to the general rules for allocation of basis in the case of stock dividends and corporate reorganizations. The bill provides that the allocation of basis shall be made under regulations provided by the Secretary or his delegate.

Where a bank holding company distributes stock of a subsidiary formed to receive either prohibited property or controlling bank interests which causes it to be a bank holding company, proper allocation of the earnings and profits of the bank holding company is made to the subsidiary. Your committee has extended such treatment to direct distributions of stock of a corporation where the bank holding company owns at least 80 percent of such corporation.

Except in the case of a distribution permitted to be made tax free under this part, nothing in this bill is intended to limit the applicability of other provisions of the Internal Revenue Code of 1954. For example, in a program of divestments under this bill a bank holding company could make distributions permitted under the tax provisions of this bill or under subchapter C of chapter 1 of the Internal Revenue Code of 1954 (relating to corporate distributions and adjustments).

DETAILED DISCUSSION

Section 10 of S. 2577, as reported by your committee, amends subchapter O of chapter 1 of the Internal Revenue Code of 1954 by adding a new part VIII. This part VIII specifies the extent to which (during a transition period after the enactment of the bill) gain will not be recognized upon receipt of property by a shareholder of a bank holding company, if such distribution is made pursuant to a certification by the Board of Governors of the Federal Reserve System that such distribution is necessary or appropriate to effectuate the Bank Holding Company Act of 1956. The provisions of the new part VIII are restricted by their own terms to the gain directly attributable to the receipt of property in the distributions specifically described.

The rules contained in part VIII are in addition to the other provisions of subtitle A of the Internal Revenue Code of 1954 (such as provisions relating to the recognition or nonrecognition of gain to a corporation making distributions, the provisions under which tax-free reorganizations may be effectuated, etc.). Many of these other provisions are contained in subchapter C of chapter 1 of such code (relating to corporate distributions and reorganizations). The provisions of part VIII supersede the other provisions of chapter 1 only in the cases qualifying under part VIII, and in those cases only to the extent specific provision is contained in part VIII. Accordingly, where the distribution to the shareholders of a bank holding company of 100 percent of the stock of another corporation meets the requirements of section 355 of the Internal Revenue Code of 1954, no gain or loss is recognized to such shareholders notwithstanding the fact that, under the provisions contained in part VIII, nonrecognition of gain or loss would not be granted, in some cases, with respect to 5 percent of such stock.

The additional amendments of your committee make certain changes in the tax provisions of the bill.

Section 1101 sets forth the conditions for nonrecognition of gain attributable to distributions of property by a qualified bank holding corporation when received by the shareholder with respect to his stock in such corporation. In addition rules are provided as to the date the qualified bank holding corporation must have acquired the property before it can be distributed with no gain recognized to its shareholders as a result of the distribution. This section also prescribes certain conditions which must be fulfilled before any such distributions of property will obtain the nonrecognition of gain benefits of its provisions.

The additional amendments of your committee revise subsection (a) of section 1101 in several respects: (1) Distributions of prohibited property consisting of stock received in an exchange to which section 1101 (c) (2) applies are treated separately from all other distributions of prohibited property; (2) provision is made for the nonrecognition of gain to certain shareholders and security holders on certain exchanges; and (3) it is specifically provided that nonrecognition treatment may be available whether or not a distribution is pro rata.

Section 1101 (a) (1) provides that a distribution of prohibited property, other than stock received in an exchange to which section 1101 (c) (2) applies, by a qualified bank holding corporation with respect to its stock and without the surrender by the shareholders of any stock in such corporation will not result in any gain being recognized on the receipt of such property by the shareholders if the Board has, before the distribution, certified that the distribution of such property is necessary or appropriate to carry out section 4 of the Bank Holding Company Act of 1956. Furthermore, under your committee's amendments, the qualified bank holding corporation may distribute such property to a shareholder in exchange for its preferred stock or to a security holder in exchange for its securities if the Board has certified that the distribution of such property is necessary or appropriate to carry out section 4 of the Bank Holding Company Act of 1956. On the date of distribution the distributing corporation must have been a qualified bank holding corporation. Section 4 provides in general that it shall be unlawful for any bank holding

company, after 2 years from the date of enactment of the Bank Holding Company Act of 1956, to own any voting shares of any company other than a bank or a bank holding company or to engage in any business other than that of banking or of managing or controlling banks or of furnishing services to or performing services for any bank of which it owns or controls 25 percent or more of the voting shares. However, section 4 (c) sets forth certain exceptions and permits the holding by a bank holding company of certain types of property.

Section 1101 (a) (2) of your committee's bill provides for the tax treatment of certain distributions of stock and securities received in an exchange to which section 1101 (c) (2) applies. A distribution of common stock received in an exchange to which section 1101 (c) (2) applies may be made by a qualified bank holding corporation to its shareholders (both common and preferred), with or without the surrender by such shareholders of their stock, without the recognition of any gain to the shareholders. Shareholders owning common stock in the distributing corporation may not receive preferred stock received in an exchange to which section 1101 (c) (2) applies with respect to their common stock without recognition of gain, whether or not they surrender common stock. Nor may shareholders owning preferred stock in the distributing corporation receive preferred stock obtained in an exchange to which section 1101 (c) (2) applies without recognition of gain without surrender of preferred stock. Similarly, in no case may security holders receive common stock, preferred stock, or securities received in an exchange to which section 1101 (c) (2) applies without recognition of gain without the surrender of securities. Preferred stock or common stock, or both, received in an exchange to which section 1101 (c) (2) applies may be distributed by a qualified bank holding corporation to shareholders owning preferred stock in exchange for their preferred stock without the recognition of gain if the preferred stock received (if any) has substantially the same terms as the preferred stock surrendered. Either common or preferred stock, or both, received in an exchange to which section 1101 (c) (2) applies may be distributed by a qualified bank holding corporation to its security holders, in exchange for their securities, without any recognition of gain to the security holders. A qualified bank holding corporation may also distribute securities received in an exchange to which subsection (c) (2) of section 1101 applies in exchange for its securities, without recognition of gain to the security holders, if the securities received have substantially the same terms as the securities surrendered. However, if the principal amount of the securities received by the security holder is greater than the principal amount of the securities surrendered, the excess principal amount does not receive nonrecognition treatment under section 1101 (a). In the case of any exchange of stock or securities of the distributing corporation it is not necessary that all of the stock or securities held by the distributee be surrendered.

A distribution may be entitled to nonrecognition treatment, with respect to shareholders, under paragraphs (1) or (2) of section 1101 (a) whether or not the distribution is pro rata with respect to all of the shareholders of the qualified bank holding corporation.

Section 1101 (b) deals with distributions in the case of a corporation ceasing to be a bank holding company. As in the case of subsection (a), the additional amendments of your committee revise subsec-

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tion (b) of section 1101 in several respects: (1) Distributions of stock received in an exchange to which section 1101 (c) (3) applies are treated separately from all other distributions of property which cause a corporation to be a bank holding company; (2) provision is made for the nonrecognition of gain to certain shareholders and security holders on certain exchanges; and (3) it is specifically provided that nonrecognition treatment may be available whether or not a distribution is pro rata. In order to provide greater clarity, your committee has also revised the description in section 1101 (b) (1) (B) of property causing a corporation to be a bank holding company.

Section 1101 (b) (1) applies to a distribution of property, other than stock received in an exchange to which section 1101 (c) (3) applies, by a qualified bank holding corporation, with respect to its stock, to a shareholder without the surrender by such shareholder of stock in such corporation where the Board has before the distribution certified that (1) such property is all or part of the property by reason of which such corporation controls within the meaning of section 2 (a) a bank or a bank holding company, or that such property is part of the property by reason of which such corporation did control a bank or a bank holding company before any property of the same kind was distributed under section 1101 (b) or exchanged under section 1101 (c) (3), and (2) the distribution is necessary or appropriate to effectuate the policies of the Bank Holding Company Act of 1956. Under your committee's amendment, the qualified bank holding corporation may also distribute such property to a shareholder in exchange for its preferred stock or to a security holder in exchange for its securities if the Board has made a similar certification. In the case of a distribution falling within subsection (b), no gain to the shareholder or security holder upon the receipt of such property is recognized. Property which is intended to be covered by section 1101 (b) (1) is that property or properties which is of a kind which causes a company to be a bank holding company within the provisions of section 2 (a) of the Bank Holding Company Act of 1956. Thus, assuming that all the conditions of this part are met, a qualified bank holding corporation may distribute to its shareholders without the recognition of gain to them upon such distribution, part or all of the voting shares of one or more of the banks the ownership of which voting shares was the basis upon which such corporation is a bank holding company, if the Board makes the certification required by section 1101 (b) (1) (B). Furthermore, if any corporation was held by the Board to be a bank holding company under clause (2) of section 2 (a) of the Bank Holding Company Act, and if such corporation is a qualified bank holding corporation as required by this part, such corporation would be permitted to distribute whatever property it owned upon the basis of which such determination was made by the Board to its shareholders without recognition of the gain on the distribution, if the Board certifies in accord with section 1101 (b) (1) (B).

Section 1101 (b) (2) of your committee's bill provides for the tax treatment of certain distributions of stock and securities received in an exchange to which section 1101 (c) (3) applies. A distribution of common stock received in an exchange to which section 1101 (c) (3) applies may be made by a qualified bank holding corporation to its shareholders (both common and preferred), with or without the surrender by such shareholders of their stock, without the recognition of

any gain to the shareholders. Shareholders owning common stock in the distributing corporation may not receive preferred stock received in an exchange to which section 1101 (c) (3) applies with respect to their common stock without recognition of gain, whether or not they surrender common stock. Nor may shareholders owning preferred stock in the distributing corporation receive preferred stock obtained in an exchange to which section 1101 (c) (3) applies without recognition of gain without surrender of preferred stock. Similarly, in no case may security holders receive common stock, preferred stock, or securities received in an exchange to which section 1101 (c) (3) applies without recognition of gain without the surrender of securities. Preferred stock or common stock, or both, received in an exchange to which section 1101 (c) (3) applies may be distributed by a qualified bank holding corporation to shareholders owning preferred stock in exchange for their preferred stock without the recognition of gain if the preferred stock received (if any) has substantially the same terms as the preferred stock surrendered. Either common or preferred stock, or both, received in an exchange to which section 1101 (c) (3) applies may be distributed by a qualified bank holding corporation to its security holders, in exchange for their securities without any recognition of gain to the security holders. A qualified bank holding corporation may also distribute securities received in an exchange to which subsection (c) (3) of section 1101 applies in exchange for its securities, without recognition of gain to the security holders, if the securities received have substantially the same terms as the securities surrendered. However, if the principal amount of the securities received by the security holder is greater than the principal amount of the securities surrendered, the excess principal amount does not receive nonrecognition treatment under section 1101 (b). In the case of any exchange of stock or securities of the distributing corporation it is not necessary that all of the stock or securities held by the distributee be surrendered.

A distribution may be entitled to nonrecognition treatment, with respect to shareholders, under paragraphs (1) or (2) of section 1101 (b) whether or not the distribution is pro rata with respect to all of the shareholders of the qualified bank holding corporation.

It is the intent of the bill that a qualified bank holding corporation must determine whether it will dispose of prohibited property and remain a bank holding company or whether it will dispose of the property upon the basis of which the corporation is determined to be a bank holding company. Therefore, section 1101 (a) (4) and (b) (4) provide that if the first distribution under this part qualifies for nonrecognition treatment under subsection (a) no distribution may qualify under subsection (b). Similarly, if the first distribution under this part qualifies for nonrecognition treatment under subsection (b) no distribution may qualify under subsection (a).

Subsection (c) of section 1101 is a limitation upon the application of subsections (a) and (b). Subparagraph (A) of paragraph (1) of subsection (c) specifically excludes from the application of subsections (a) and (b) of section 1101 any property which a qualified bank holding corporation acquired after May 15, 1955, except to the extent such corporation received such property (even though subsequent to May 15, 1955) and (1) gain was not recognized by reason of subsection (a) or (b), or (2) the property was received by the corporation in

exchange for all of its stock in an exchange to which paragraph (2) or (3) of subsection (c) applies, or (3) such property was acquired by the distributing corporation in a transaction in which gain was not recognized under section 305 (a) or section 332, or under section 354 by reason of a reorganization described in section 368 (a) (1) (E) or (F) (recapitalization or mere change in identity, form, or place of organization).

Under subparagraph (B) of paragraph (1), neither subsection (a) nor (b) of section 1101 is applicable to the distribution by a qualified bank holding corporation of property which was acquired by such corporation in a distribution with respect to stock acquired by it after May 15, 1955, unless such stock was acquired by it (1) in a distribution (with respect to stock held by it on May 15, 1955, or with respect to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b) of section 1101, or (2) in exchange for all of its stock in an exchange meeting the requirements of section 1101 (c) (2) or (3), or (3) in a transaction in which gain was not recognized under section 305 (a) or section 332, or under section 354 by reason of a reorganization described in section 368 (a) (1) (E) or (F).

Paragraphs (2) and (3) of subsection (c) of section 1101 are exceptions to the general rule of paragraph (1) of subsection (c) that subsections (a) and (b) do not apply to any property acquired by a distributing corporation after May 15, 1955. In general paragraphs (2) and (3) permit the distribution of the stock and securities of corporations organized to receive property which could have been distributed directly. Under the tax provisions of S. 2577 as originally reported by your committee, the corporation organized under these paragraphs could receive only property which could have been distributed directly without recognition of gain to shareholders. The amendments proposed by your committee permit the transfer of additional property (including cash) when there is not a plan to avoid Federal income tax.

Under subparagraph (C) of paragraph (1), neither subsection (a) nor (b) of section 1101 is applicable to the distribution by a qualified bank holding corporation of property acquired by such corporation in a transaction in which gain was not recognized under section 332, unless such property was acquired from a corporation which, if it had been a qualified bank holding corporation, could have distributed such property under section 1101 (a) (1) or (b) (1).

Under paragraph (2) if a qualified bank holding corporation exchanges property which, under subsection (a) (1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain to such shareholders or security holders and other property (except property described in section 1101 (b) (1) (B) (i)) for all of the stock of a second corporation created and availed of solely for the purpose of receiving such property, and immediately after the exchange, the qualified bank holding corporation distributes all of such stock in a manner prescribed in section 1101 (a) (2) (A), then the stock and securities of the second corporation may be distributed to the shareholders and security holders of such qualified bank holding corporation in distributions meeting the requirements of section 1101 (a) (2). However, prior to such exchange, the Board must certify, with respect to the property exchanged consisting of

property which the corporation could have distributed directly to its shareholders or security holders without recognition of gain under section 1101 (a) (1), that the exchange and distribution are necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956.

Under paragraph (3) of section 1101 (c) if any qualified bank holding corporation exchanges property which it could have distributed directly to its shareholders or security holders without recognition of gain to them under section 1101 (b) (1) and other property (except prohibited property), for all of the stock of a second corporation created and availed of solely for the purpose of receiving such property, and immediately after the exchange the qualified bank holding corporation distributes all of such stock in a manner prescribed in section 1101 (b) (2) (A), then the stock and securities of the second corporation may be distributed to the shareholders and security holders of such qualified bank holding corporation in distributions meeting the requirements of section 1101 (b) (2). However, prior to such exchange the Board must have certified, with respect to the property exchanged consisting of property which the corporation could have distributed directly to its shareholders or security holders without recognition of gain under section 1101 (b) (1), that (1) such property is all or part of the property by reason of which such corporation controls within the meaning of section 2 (a) a bank or a bank holding company, or that such property is part of the property by reason of which the corporation did control a bank or a bank holding company before any property of the same kind was distributed under section 1101 (b) (1) or exchanged under section 1101 (c) (3), and (2) the exchange and distribution are necessary and appropriate to effectuate the policies of the Bank Holding Company Act of 1956.

An exchange will meet the requirements of section 1101 (c) (2) or (3) even though the only property transferred by the qualified bank holding corporation is property which could have been distributed to its shareholders or security holders directly without the recognition of gain to them. However, the distribution of the stock and securities of the corporation receiving such property will not receive the nonrecognition treatment provided in sections 1101 (a) and (b) if property of the type referred to in section 1101 (d) is retained in pursuance of a plan to avoid Federal income tax. The qualified bank holding corporation making an exchange under section 1101 (c) (2) or (3) may receive securities of the second corporation in addition to all of the stock of such corporation. However, the securities received may be distributed without recognition of gain only to the extent provided in section 1101 (a) (2) and (b) (2).

Your committee has amended the tax provisions of S. 2577, as originally reported, to provide, in section 1101 (d), that distributions which are a part of a plan to avoid Federal income tax will not qualify for nonrecognition treatment under sections 1101 (a) and (b). This amendment to the bill adopts an approach analogous to that used in section 355 (a) (1) (B) of the Internal Revenue Code of 1954. This amendment is applicable both to direct distributions of property and to distributions of the stock and securities received in an exchange to which section 1101 (c) (2) or (3) applies. Paragraph (1) of section 1101 (d) provides that section 1101 (a) shall not apply to a distribution of nonbanking property if, in connection with such distribution, the

distributing corporation retains, or transfers after May 15, 1955, to any corporation, property (other than prohibited property) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation. Similarly, paragraph (2) of section 1101 (d) provides that section 1101 (b) shall not apply to a distribution of banking property if, in connection with such distribution, the distributing corporation retains, or transfers after May 15, 1955, to any corporation property (other than property described in sec. 1101 (b) (1) (B) (i)) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation.

Your committee has adopted an amendment providing a special rule for contributions to capital of a corporation made after May 15, 1955, and prior to the date of enactment. Paragraph (3) of section 1101 (d) provides that in a case of a distribution a portion of which is attributable to a transfer which is a contribution to the capital of a corporation, made after May 15, 1955, and prior to the date of enactment, if section 1101 (a) or (b) would apply to such distribution but for the fact that such contribution to capital is part of a tax avoidance plan under paragraph (1) or (2) of section 1101 (d), then, notwithstanding paragraph (1) or (2) of subsection (d), section 1101 (a) or (b) shall apply to that portion of such distribution not attributable to such contribution to capital and shall not apply to that portion attributable to such contribution to capital.

The preceding paragraph may be illustrated by the following examples:

(1) Assume that corporation A (a qualified bank holding corporation) owns all of the stock of corporation X. Assume further that corporation A, after May 15, 1955, and prior to the date of the enactment of this bill, makes a contribution to the capital of corporation X in the amount of $50,000 in pursuance of a plan to avoid Federal income tax under paragraph (1) or (2) of section 1101 (d). Thereafter, corporation A makes a distribution of the stock of corporation X to the shareholders of corporation A which would be entitled to nonrecognition treatment but for the tax avoidance plan. Under subsection (d) the nonrecognition of gain provided by subsection (a) does not apply to that portion of the distribution which is attributable to the contribution of capital, that is, $50,000. The amount of the distribution to the extent of the contribution to capital, $50,000, is a distribution subject to the provisions of section 301 of the Internal Revenue Code of 1954.

(2) The facts are the same as in example (1) above, except that the value of the portion of the distribution which is attributable to the contribution to capital, at the time of the distribution, is less than $50,000. The value of that portion of the distribution which is attributable to the contribution to capital of $50,000 is a distribution subject to the provisions of section 301 of the Internal Revenue Code of 1954.

Subsection (e) of section 1101 provides that neither subsection (a) nor subsection (b) shall apply with respect to any distribution by a corporation unless the board makes the certification required by the subsection.

Paragraph (1) of subsection (e) relates to certification with respect to distributions falling within subsection (a). It provides that sub-

section (a) shall not apply to any such distribution unless the Board certifies that, before the expiration of the period permitted under section 4 (a) of the Bank Holding Company Act of 1956 (including any extensions thereof granted to such corporation under such sec. 4 (a)), the corporation has disposed of all the property, the disposition of which is necessary or appropriate to effectuate section 4 (or would have been so necessary or appropriate if the corporation had continued to be a bank holding company). In order that subsection (a) of section 1101 is to apply to distributions of property by a qualified bank holding corporation, it is essential that such corporation dispose of all of such property within the period (including extensions thereof) specified in section 4 (a) of such act. During the period during which such corporation is required to dispose of all such property, distributions of property are to be considered as being within subsection (a) of section 1101, if other requirements of this part are met. Thus, no gain would be recognized to shareholders on distributions (if such distributions would otherwise qualify for the benefits of this part) during such period. If, at the close of such period, the corporation has disposed of all of such property and the Board has made the certification required under subsection (e) of section 1101, subsection (a) of section 1101 will apply to distributions of property. However, if, at the close of such period, the corporation has not disposed of all of the property the disposition of which is necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956, then subsection (a) of section 1101 will not apply to any distributions of property by the corporation. Thus, in a case where the provisions of subsection (e) (1) are not met, the tax treatment of any distribution of property by a qualified bank holding corporation to its shareholders is governed by the provisions of other sections of the Internal Revenue Code of 1954 applicable thereto.

Paragraph (2) of subsection (e) of section 1101 is applicable to distributions falling within subsection (b) of section 1101. Subparagraph (A) provides that subsection (b) shall not apply unless the Board certifies that the corporation has ceased to be a bank holding company before the expiration of the period specified in subparagraph (B). Under H. R. 6227 the period specified in paragraph (B) was 2 years after the date of enactment. S. 2577, as originally reported, modified subparagraph (B) to provide that the specified period expires 2 years after the enactment of this part or 2 years after the corporation becomes a bank holding company, whichever is later. Under subparagraph (B) of H. R. 6227 the Board is authorized on the application of any qualified bank holding corporation to extend such period from time to time with respect to such corporation for not more than 1 year at a time if, in its judgment, such an extension would not be detrimental to the public interest, but such period might not be extended beyond the date 5 years after the date of enactment of this part. This provision was modified by S. 2577, as originally reported, to provide that such period may not in any case be extended beyond the date 5 years after the date of enactment of this part or 5 years after the date on which the corporation becomes a bank holding company, whichever is later. The purpose of this change was to extend the specified periods in the case of corporations which become bank holding companies after the date of enactment of this part by reason of a distribution under section 1101. This treatment makes the

specified periods uniform whether such a corporation chooses to distribute prohibited property or bank stock. In order that subsection (b) of section 1101 is to apply to distributions of property of a kind which causes a qualified bank holding corporation to be a bank holding company and the disposition of which is necessary to enable such corporation to cease being a bank holding company, it is essential that such corporation cease to be a bank holding company within the period (including extensions thereof) specified in subsection (e) (2) of section 1101. During the period during which such corporation disposes of property to enable it to cease being a bank holding company, distributions of such property are to be considered as being within subsection (b) of section 1101, if other requirements of this part are met. Thus, no gain would be recognized to shareholders on such distributions (if such distributions would otherwise qualify for the benefits of this part) during such period. If, at the close of such period specified in subsection (e) (2), the corporation has ceased to be a bank holding company, subsection (b) of section 1101 will apply to distributions of such property. However, if, at the close of such period, the corporation has not ceased being a bank holding company, then subsection (b) of section 1101 will not apply to any distributions of such property by the corporation. Thus, in a case where the provisions of subsection (e) (2) are not met, the tax treatment of any distributions of property of a kind which causes a qualified bank holding corporation to be a bank holding company to its shareholders is governed by the provisions of other sections of the Internal Revenue Code of 1954 applicable thereto.

Section 1102 provides special rules for the application of this part.

Subsection (a) relates to the basis of property acquired in distributions under either subsection (a) or subsection (b) of section 1101.

Paragraph (1) of subsection (a) relates to the basis of property received by a shareholder with respect to stock without the surrender by such shareholder of stock. If gain is not recognized by reason of section 1101 (a) or (b) with respect to the receipt of any property then, under paragraph (1), the basis of such property and of the stock with respect to which it was distributed shall, in the hands of the distributee, be determined by allocating the adjusted basis of such stock between such property and such stock. Such allocation shall be made under regulations prescribed by the Secretary or his delegate.

Paragraph (2) of subsection (a) relates to the basis of property received by a shareholder in exchange for stock or by a security holder in exchange for securities. If gain is not recognized by reason of section 1101 (a) or (b) with respect to the receipt of any property then, under regulations prescribed by the Secretary or his delegate, the basis of the property received shall, in the distributee's hands, be the same as the adjusted basis of the stock or securities exchanged, increased by (1) the amount of the property received which was treated as a dividend and (2) the amount of gain to the taxpayer recognized on the property received (not including any portion of such a gain which was treated as a dividend).

Subsection (b) of section 1102 of H. R. 6227 provided for the extension of the periods of limitation on the assessment and collection of deficiencies in tax arising from distributions to which subsection (a) or (b) of section 1101 applies. S. 2577, as originally reported, modified this provision of the House bill in several respects: (1) It eliminated

the extension of the period under section 6502 relating to collection as unnecessary; (2) it provided that the extension applies to distributions certified by the Board under subsection (a) or (b) of section 1101 in order to correct a technical defect; (3) it provided that the notification by the corporation be in such manner and with such accompanying information as prescribed in regulations by the Secretary or his delegate; (4) it provided for a 5-year period after the notification instead of a 1-year period; and (5) it provided that the notification can only be made after the expiration of the period prescribed in section 4 (a) of the Bank Holding Company Act or section 1101 (e), whichever is applicable, instead of after a final certification by the Board. The additional amendments proposed by your committee provide that the extension applies to all distributions certified by the Board under subsection (a), (b), or (c) of section 1101. Accordingly, under subsection (b) of section 1102, the periods of limitation provided in section 6501 (relating to limitations on assessment) shall not expire, with respect to any deficiency (including interest and additions to the tax) resulting solely from the receipt of property by shareholders in a distribution which is certified by the Board under subsection (a), (b), or (c) of section 1101, until 5 years after the distributing corporation notifies the Secretary or his delegate (in such manner and with such accompanying information as the Secretary or his delegate may by regulations prescribe) that the period (including extensions thereof) prescribed in section 4 (a) of the Bank Holding Company Act, or section 1101 (e) (2) (B), whichever is applicable, has expired. Such assessment may be made notwithstanding any provision of law or rule of law which would otherwise prevent such assessment.

Subsection (c) of section 1102 relates to allocation of earnings and profits. The amendments proposed by your Committee extend the rule relating to allocation of earnings and profits contained in section 1102 (c) of S. 2577 as originally reported by your committee to the distribution of stock in a controlled corporation. Your committee believes it appropriate to provide a rule which is similar to that applied under section 312 (i) in cases involving the distribution of stock of a controlled corporation under section 355. Accordingly, paragraph (1) of section 1101 (c) provides that in the case of a distribution by a qualified bank holding corporation under section 1101 (a) (1) or (b) (1) of stock in a controlled corporation, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation shall be made under regulations prescribed by the Secretary or his delegate. (Par. (3) of sec. 1101 (c) defines the term "controlled corporation" in the same manner as sec. 368 (c) of the Internal Revenue Code of 1954.) Paragraph (2) of section 1101 (c) provides that in the case of any exchange described in section 1101 (c) (2) or (3), the earnings and profits of the corporation transferring the property shall be properly allocated between such corporation and the corporation receiving such property under regulations prescribed by the Secretary or his delegate.

Subsection (d) relates to itemization of property distributed. The Board is required in any certification under this part to make such specification and itemization of property as may be necessary to carry out the provisions of this part.

Section 1103 sets forth the definitions, for purpose of this part, of "bank holding company," "qualified bank holding corporation," "prohibited property," "nonexempt property," and "Board."

Subsection (a) of this section provides that the term "bank holding company" means a bank holding company as defined by section 2 of the Bank Holding Company Act of 1956.

Subsection (b) of this section defines the term "qualified bank holding corporation." S. 2577, as originally reported, made a technical amendment to subsection (b) in order to make it clear that the tax provisions of this part apply to any corporation as defined in section 7701 (a) (3) of the Internal Revenue Code of 1954 if such corporation is a qualified bank holding corporation. In order for a corporation to be a qualified bank holding corporation, and therefore for its shareholders to receive the special tax treatment provided by this part, it must not only be a bank holding company but, in addition, it must hold "prohibited property" as defined in subsection (c). For example, if the sole assets of corporation X consist of 25 percent of the voting shares of each of two banks, corporation X is not a qualified bank holding corporation.

In addition, to be a qualified bank holding corporation the prohibited property must have been acquired on or before May 15, 1955, by a corporation which is a bank holding company, or must have been acquired in a distribution to it by a qualified bank holding corporation with respect to which gain is not recognized by reason of section 1101 (a) or (b). Furthermore, a bank holding company which holds prohibited property acquired by it in exchange for all of its stock in an exchange described in section 1101 (c) (2) or (3) is a qualified bank holding corporation. (The amendments proposed by your committee add references to sec. 1101 (b) and sec. 1101 (c) (2) to par. (1) of sec. 1103 (b) in order to conform the tax provisions of this bill to the change proposed by your committee in sec. 4 (a) (2) of this bill.)

The preceding paragraph may be illustrated by the following examples:

(1) If the sole assets of corporation X on May 15, 1955, consist of cash and 25 percent of the voting shares of each of two banks and on May 30, 1955, corporation X purchases nonbanking business assets, corporation X is not a qualified bank holding corporation.

(2) The sole assets of corporation Y, on May 15, 1955, consist of 25 percent of the voting shares of each of two banks and 4 percent of the outstanding voting stocks (the value of which is less than 5 percent of the value of corporation Y's total assets) of corporation Z, a qualified bank holding corporation. Corporation Z distributes nonbanking business assets to corporation Y which are prohibited property in the hands of corporation Y, in a distribution to which section 1101 (a) applies. Corporation Y becomes a qualified bank holding corporation by reason of the distribution by Z.

Notwithstanding that a corporation meets the requirements of paragraph (1) of subsection (b), such corporation shall not be a qualified bank holding corporation unless it meets the additional requirements of subparagraphs (A), (B), and (C) of paragraph (2).

Subparagraph (A) of paragraph (2) provides that a bank holding company shall not be a qualified bank holding corporation unless such corporation would have been a bank holding company on May 15, 1955, if the Bank Holding Company Act of 1956 had been in effect on such date, or unless such corporation is a bank holding company determined solely by reference to the following: (1) Property acquired by such corporation on or before May 15, 1955; (2) property

acquired by such corporation in a distribution by a qualified bank holding corporation to such corporation wherein gain was not recognized by reason of subsection (a) or (b) of section 1101; and (3) property acquired by such corporation in exchange for all of its stock in an exchange meeting the requirements of section 1101 (c) (2) or (3).

Thus, if on May 15, 1955, the sole assets of corporation X consist of cash and business assets and on May 30, 1955, corporation X acquires 25 percent of the voting shares of each of two banks for cash, then, by reason of subparagraph (A) of paragraph (2), corporation X, although a bank holding company holding prohibited property acquired by it before May 15, 1955, is not a qualified bank holding corporation. Similarly, if corporation X acquired 25 percent or more of the voting shares of each of two banks in a tax-free reorganization, corporation X, although a bank holding company holding prohibited property acquired by it before May 15, 1955, would not be a qualified bank holding corporation. An additional example of the application of subparagraph (A) of paragraph (2) is where corporation X is determined by the Board to be a bank holding company by reason of clause (2) of section 2 (a) of the Bank Holding Corporation Act of 1956, solely by reference to (1) property acquired by such corporation on or before May 15, 1955, and (2) property acquired by it from a qualified bank holding corporation in a distribution in which gain to the distributee was not recognized by reason of subsection (a) or (b) of section 1101.

Except as explained in the next paragraph, subparagraph (B) of paragraph (2) provides that a bank holding company shall not be a qualified bank holding corporation by reason of either (1) the acquisition by such bank holding company of prohibited property after May 15, 1955, in a distribution from a qualified bank holding corporation to which section 1101 (a) is applicable or (2) the acquisition by such bank holding company (which company would not have been a bank holding company on May 15, 1955, if the Bank Holding Company Act of 1956 had been in effect on such date) of property described in clause (ii) of subparagraph (A) of paragraph (2). An example of the operation of the foregoing is where, on May 15, 1955, the sole assets of corporation Y consist of cash and 25 percent of the voting shares of each of two banks. On May 30, 1955, corporation Y purchases for cash 50 percent of the stock of corporation Z, a qualified bank holding corporation. Corporation Z distributed business assets to corporation Y in a distribution in which gain to corporation Y with respect to the receipt of such property was not recognized by reason of section 1101 (a). Corporation Y is not a qualified bank holding corporation since such property was acquired by corporation Y in a distribution with respect to stock acquired after May 15, 1955.

A bank holding company may be a qualified bank holding corporation by reason of the property described in the preceding paragraph if such property was acquired in a distribution with respect to stock which was acquired by such company (1) on or before May 15, 1955, (2) in a distribution (with respect to stock held by it on May 15, 1955, or with respect to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b) of section 1101, or (3) in

exchange for all of the stock of the bank holding company in an exchange meeting the requirements of section 1101 (c) (2) or (3).

Subparagraph (C) of paragraph (2) states that a corporation may not be treated as a qualified bank holding corporation unless the Board certifies that it satisfies the requirements of subsection (b) of section 1103.

Subsection (c) of section 1103 defines the term "prohibited property." Such property is defined as property, other than nonexempt property, the disposition of which, in the case of any bank holding company, would be necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956, if such company continued to be a bank holding company beyond the period (including any extensions thereof) specified in section 4 (a), in the case of distributions under section 1101 (a), or specified in section 1101 (e) (2) (B), in the case of distributions under section 1101 (b). The term "prohibited property" does not include shares of any company which are held by a bank holding company to the extent that the ownership by such bank holding company of such property is not prohibited by section 4 of such bill by reason of subsection (c) (5) of such section.

Subsection (d) defines the term "nonexempt property," the distribution of which may not be accorded the tax treatment provided by this part.

Subsection (e) of this section states that the term "Board" means the Board of Governors of the Federal Reserve System.

Section 10 (b) amends table of parts of chapter 1, subchapter O of Internal Revenue Code of 1954 by adding "Part VIII. Distributions pursuant to Bank Holding Company Act of 1955."

Section 10 (c) makes these tax provisions in section 10 (a) apply to taxable years ending after the enactment of the act.

Changes in Existing Law

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (new matter is printed in italics, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

Chapter I—Normal Taxes and Surtaxes

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SUBCHAPTER O—GAIN OR LOSS ON DISPOSITION OF PROPERTY

Part I. Determination of amount and recognition of gain or loss.
Part II. Basic rules of general application.
Part III. Common nontaxable exchanges.
Part IV. Special rules.
Part V. Changes to effectuate F. C. C. policy.
Part VI. Exchanges in obedience to S. E. C. orders.
Part VII. Wash sales of stock or securities.
Part VIII. Distributions pursuant to Bank Holding Company Act of 1955.

* * * * * * *

Part VIII—Distributions Pursuant to Bank Holding Company Act of 1956

Sec. 1101. Distributions pursuant to Bank Holding Company Act of 1956.
Sec. 1102. Special rules.
Sec. 1103. Definitions.

SEC. 1101. DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956.

(a) DISTRIBUTIONS OF CERTAIN NON-BANKING PROPERTY.—

(1) DISTRIBUTIONS OF PROHIBITED PROPERTY.—

If—

(A) a qualified bank holding corporation distributes prohibited property (other than stock received in an exchange to which subsection (c) (2) applies)—

(i) to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) to a shareholder, in exchange for its preferred stock; or

(iii) to a security holder, in exchange for its securities; and

(B) the Board has, before the distribution, certified that the distribution of such prohibited property is necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956,

then no gain to the shareholder or security holder from the receipt of such property shall be recognized.

(2) DISTRIBUTIONS OF STOCK AND SECURITIES RECEIVED IN AN EXCHANGE TO WHICH SUBSECTION (c) (2) APPLIES.—*If—*

(A) a qualified bank holding corporation distributes—

(i) common stock received in an exchange to which subsection (c) (2) applies to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) common stock received in an exchange to which subsection (c) (2) applies to a shareholder, in exchange for its common stock; or

(iii) preferred stock or common stock received in an exchange to which subsection (c) (2) applies to a shareholder, in exchange for its preferred stock; or

(iv) securities or preferred or common stock received in an exchange to which subsection (c) (2) applies to a security holder, in exchange for its securities; and

(B) any preferred stock received has substantially the same terms as the preferred stock exchanged, and any securities received have substantially the same terms as the securities exchanged,

then, except as provided in subsection (f), no gain to the shareholder or security holder from the receipt of such stock or such securities or such stock and securities shall be recognized.

(3) NON PRO RATA DISTRIBUTIONS.—*Paragraphs (1) and (2) shall apply to a distribution whether or not the distribution is pro rata with respect to all of the shareholders of the distributing qualified bank holding corporation.*

(4) EXCEPTION.—*This subsection shall not apply to any distribution by a corporation which has made any distribution pursuant to subsection (b).*

(5) DISTRIBUTIONS INVOLVING GIFT OR COMPENSATION.—

In the case of a distribution to which paragraph (1) or (2) applies, but which—

(A) results in a gift, see section 2501, and following, or

(B) has the effect of the payment of compensation, see section 61 (a) (1).

(b) CORPORATION CEASING TO BE A BANK HOLDING COMPANY.—

(1) DISTRIBUTIONS OF PROPERTY WHICH CAUSE A CORPORATION TO BE A BANK HOLDING COMPANY.—*If—*

(A) a qualified bank holding corporation distributes property (other than stock received in an exchange to which subsection (c) (3) applies)—

(i) to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) to a shareholder, in exchange for its preferred stock; or

(iii) to a security holder, in exchange for its securities; and

(B) the Board has, before the distribution, certified that—

(i) such property is all or part of the property by reason of which such corporation controls (within the meaning of section 2 (a) of the Bank Holding Company Act of 1956) a bank or bank holding company, or such property is part of the property by reason of which such corporation did control a bank or a bank holding company before any property of the same kind was distributed under this subsection or exchanged under subsection (c) (3), and

(ii) the distribution is necessary or appropriate to effectuate the policies of such Act, then no gain to the shareholder or security holder from the receipt of such property shall be recognized.

(2) DISTRIBUTIONS OF STOCK AND SECURITIES RECEIVED IN AN EXCHANGE TO WHICH SUBSECTION (c) (3) APPLIES.—If—

(A) a qualified bank holding corporation distributes—

(i) common stock received in an exchange to which subsection (c) (3) applies to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) common stock received in an exchange to which subsection (c) (3) applies to a shareholder, in exchange for its common stock; or

(iii) preferred stock or common stock received in an exchange to which subsection (c) (3) applies to a shareholder, in exchange for its preferred stock; or

(iv) securities or preferred or common stock received in an exchange to which subsection (c) (3) applies to a security holder, in exchange for its securities; and

(B) any preferred stock received has substantially the same terms as the preferred stock exchanged, and any securities received have substantially the same terms as the securities exchanged,

then, except as provided in subsection (f), no gain to the shareholder or security holder from the receipt of such stock or such securities or such stock and securities shall be recognized.

(3) NON PRO RATA DISTRIBUTIONS.—Paragraphs (1) and (2) shall apply to a distribution whether or not the distribution is pro rata with respect to all of the shareholders of the distributing qualified bank holding corporation.

(4) EXCEPTION.—This subsection shall not apply to any distribution by a corporation which has made any distribution pursuant to subsection (a).

(5) DISTRIBUTIONS INVOLVING GIFT OR COMPENSATION.—

In the case of a distribution to which paragraph (1) or (2) applies, but which—

(A) results in a gift, see section 2501, and following, or

(B) has the effect of the payment of compensation, see section 61 (a) (1).

(c) PROPERTY ACQUIRED AFTER MAY 15, 1955.—

(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), subsection (a) or (b) shall not apply to—

(A) any property acquired by the distributing corporation after May 15, 1955, unless (i) gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b), or (ii) such property was received by it in exchange for all of its stock in an exchange to which paragraph (2) or (3) applies, or (iii) such property was acquired by the distributing corporation in a transaction in which gain was not recognized under section 305 (a) or section 332, or under section 354 with respect to a reorganization described in section 368 (a) (1) (E) or (F), or

(B) any property which was acquired by the distributing corporation in a distribution with respect to stock acquired by such corporation after May 15, 1955, unless such stock was acquired by such corporation (i) in a distribution (with respect to stock held by it on May 15, 1955, or with respect to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b), or (ii) in exchange for all of its stock in an exchange to which paragraph (2) or (3) applies, or (iii) in a transaction in which gain was not recognized under section 305 (a) or section 332, or under section 354 with respect to a reorganization described in section 368 (a) (1) (E) or (F), or

(C) any property acquired by the distributing corporation in a transaction in which gain was not recognized under section 332, unless such property was acquired from a corporation which, if it had been a qualified bank holding corporation, could have distributed such property under subsection (a) (1) or (b) (1).

(2) EXCHANGES INVOLVING PROHIBITED PROPERTY.—If—

(A) any qualified bank holding corporation exchanges (i) property, which, under subsection (a) (1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain to such shareholders or security holders, and other property (except property described in

subsection (b) (1) (B) (i)), for (ii) all of the stock of a second corporation created and availed of solely for the purpose of receiving such property;

(B) immediately after the exchange, the qualified bank holding corporation distributes all of such stock in a manner prescribed in subsection (a) (2) (A); and

(C) before such exchange, the Board has certified (with respect to the property exchanged which consists of property which, under subsection (a) (1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain) that the exchange and distribution are necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956,

then paragraph (1) shall not apply with respect to such distribution.

(3) EXCHANGES INVOLVING INTERESTS IN BANKS.—If—

(A) any qualified bank holding corporation exchanges (i) property which, under subsection (b) (1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain to such shareholders or security holders, and other property (except prohibited property), for (ii) all of the stock of a second corporation created and availed of solely for the purpose of receiving such property,

(B) immediately after the exchange, the qualified bank holding corporation distributes all of such stock in a manner prescribed in subsection (b) (2) (A); and

(C) before such exchange, the Board has certified (with respect to the property exchanged which consists of property which, under subsection (b) (1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain) that—

(i) such property is all or part of the property by reason of which such corporation controls (within the meaning of section 2 (a) of the Bank Holding Company Act of 1956) a bank or bank holding company, or such property is part of the property by reason of which such corporation did control a bank or a bank holding company before any property of the same kind was distributed under subsection (b) (1) or exchanged under this paragraph, and

(ii) the exchange and distribution are necessary or appropriate to effectuate the policies of such Act,

then paragraph (1) shall not apply with respect to such distribution.

(d) DISTRIBUTIONS TO AVOID FEDERAL INCOME TAX.—

(1) PROHIBITED PROPERTY.—Subsection (a) shall not apply to a distribution if, in connection with such distribution, the distributing corporation retains, or transfers after May 15, 1955, to any corporation, property (other than prohibited property) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation.

(2) BANKING PROPERTY.—Subsection (b) shall not apply to a distribution if, in connection with such distribution, the distributing corporation retains, or transfers after May 15, 1955, to any corporation, property (other than property described in subsection (b) (1) (B) (i)) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation.

(3) CERTAIN CONTRIBUTIONS TO CAPITAL.—In the case of a distribution a portion of which is attributable to a transfer which is a contribution to the capital of a corporation, made after May 15, 1955, and prior to the date of the enactment of this part, if subsection (a) or (b) would apply to such distribution but for the fact that, under paragraph (1) or (2) (as the case may be) of this subsection, such contribution to capital is part of a plan one of the principal purposes of which is to distribute the earnings and profits of any corporation, then, notwithstanding paragraph (1) or (2), subsection (a) or (b) (as the case may be) shall apply to that portion of such distribution not attributable to such contribution to capital, and shall not apply to that portion of such distribution attributable to such contribution to capital.

(e) FINAL CERTIFICATION.—

(1) FOR SUBSECTION (a).—Subsection (a) shall not apply with respect to any distribution by a corporation unless the Board certifies that, before the expiration of the period permitted under section 4 (a) of the Bank Holding Company Act of 1956 (including any extensions thereof granted to such corporation under such section 4 (a)), the corporation has disposed of all the property the disposition of which is necessary or appropriate to effectuate section 4 of such Act (or would have been so necessary or appropriate if the corporation had continued to be a bank holding company).

(2) FOR SUBSECTION (b).—

(A) Subsection (b) shall not apply with respect to any distribution by any corporation unless the Board certifies that, before the expiration of the period specified in subparagraph (B), the corporation has ceased to be a bank holding company.

(B) The period referred to in subparagraph (A) is the period which expires 2 years after the date of the enactment of this part or 2 years after the date on which the corporation becomes a bank holding company, whichever date is later. The Board is authorized, on application by any corporation, to extend such period from time to time with respect to such corporation for not more than one year at a time if, in its judgment, such an extension would not be detrimental to the public interest; except that such period may not in any case be extended beyond the date 5 years after the date of the enactment of this part or 5 years after the date on which the corporation becomes a bank holding company, whichever date is later.

(f) CERTAIN EXCHANGES OF SECURITIES.—In the case of an exchange described in subsection (a) (2) (A) (iv) or subsection (b) (2) (A) (iv), subsection (a) or subsection (b) (as the case may be) shall apply only to the extent that the principal amount of the securities received does not exceed the principal amount of the securities exchanged.

SEC. 1102. SPECIAL RULES.

(a) BASIS OF PROPERTY ACQUIRED IN DISTRIBUTIONS.—If, by reason of section 1101, gain is not recognized with respect to the receipt of any property, then, under regulations prescribed by the Secretary or his delegate—

(1) if the property is received by a shareholder with respect to stock, without the surrender by such shareholder of stock, the basis of the property received and of the stock with respect to which it is distributed shall, in the distributee's hands, be determined by allocating between such property and such stock the adjusted basis of such stock; or

(2) if the property is received by a shareholder in exchange for stock or by a security holder in exchange for securities, the basis of the property received shall, in the distributee's hands, be the same as the adjusted basis of the stock or securities exchanged, increased by—

(A) the amount of the property received which was treated as a dividend, and

(B) the amount of gain to the taxpayer recognized on the property received (not including any portion of such gain which was treated as a dividend).

(b) PERIODS OF LIMITATION.—The periods of limitation provided in section 6501 (relating to limitations on assessment and collection) shall not expire, with respect to any deficiency (including interest and additions to the tax) resulting solely from the receipt of property by shareholders in a distribution which is certified by the Board under subsection (a), (b), or (c) of section 1101, until 5 years after the distributing corporation notifies the Secretary or his delegate (in such manner and with such accompanying information as the Secretary or his delegate may by regulations prescribe) that the period (including extensions thereof) prescribed in section 4 (a) of the Bank Holding Company Act of 1956, or section 1101 (c) (2) (B), whichever is applicable, has expired; and such assessment may be made notwithstanding any provision of law or rule of law which would otherwise prevent such assessment.

(c) ALLOCATION OF EARNINGS AND PROFITS.—

(1) DISTRIBUTION OF STOCK IN A CONTROLLED CORPORATION.—In the case of a distribution by a qualified bank holding corporation under section 1101 (a) (1) or (b) (1) of stock in a controlled corporation, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation shall be made under regulations prescribed by the Secretary or his delegate.

(2) EXCHANGES DESCRIBED IN SECTION 1101 (c) (2) OR (3).—In the case of any exchange described in section 1101 (c) (2) or (3), proper allocation with respect to the earnings and profits of the corporation transferring the property and the corporation receiving such property shall be made under regulations prescribed by the Secretary or his delegate.

(3) DEFINITION OF CONTROLLED CORPORATION.—For purposes of paragraph (1), the term "controlled corporation" means a corporation with respect to which at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock is owned by the distributing qualified bank holding corporation.

(d) ITEMIZATION OF PROPERTY.—In any certification under this part, the Board shall make such specification and itemization of property as may be necessary to carry out the provisions of this part.

SEC. 1103. DEFINITIONS.

(a) BANK HOLDING COMPANY.—For purposes of this part, the term "bank holding company" has the meaning assigned to such term by section 2 of the Bank Holding Company Act of 1956.

(b) QUALIFIED BANK HOLDING CORPORATION.—

(1) IN GENERAL.—Except as provided in paragraph (2), for purposes of this part the term "qualified bank holding corporation" means any corporation (as defined in section 7701 (a) (3)) which is a bank holding company and which holds prohibited property acquired by it—

(A) on or before May 15, 1955,

(B) in a distribution in which gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b) of section 1101, or

(C) in exchange for all of its stock in an exchange described in section 1101 (c) (2) or (c) (3).

(2) LIMITATIONS.—

(A) A bank holding company shall not be a qualified bank holding corporation, unless it would have been a bank holding company on May 15, 1955, if the Bank Holding Company Act of 1956 had been in effect on such date, or unless it is a bank holding company determined solely by reference to—

(i) property acquired by it on or before May 15, 1955.

(ii) property acquired by it in a distribution in which gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b) of section 1101, and

(iii) property acquired by it in exchange for all of its stock in an exchange described in section 1101 (c) (2) or (3).

(B) A bank holding company shall not be a qualified bank holding corporation by reason of property described in subparagraph (B) of paragraph (1) or clause (ii) of subparagraph (A) of this paragraph, unless such property was acquired in a distribution with respect to stock, which stock was acquired by such bank holding company—

(i) on or before May 15, 1955.

(ii) in a distribution (with respect to stock held by it on May 15, 1955, or with respect to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b) of section 1101, or

(iii) in exchange for all of its stock in an exchange described in section 1101 (c) (2) or (3).

(C) A corporation shall be treated as a qualified bank holding corporation only if the Board certifies that it satisfies the foregoing requirements of this subsection.

(c) PROHIBITED PROPERTY.—For purposes of this part, the term "prohibited property" means, in the case of any bank holding company, property (other than nonexempt property) the disposition of which would be necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956 if such company continued to be a bank holding company beyond the period (including any extensions thereof) specified in subsection (a) of such section or in section 1101 (c) (2) (B) of this part, as the case may be. The term "prohibited property" does not include shares of any company held by a bank holding company to the extent that the prohibitions of section 4 of the Bank Holding Company Act of 1956 do not apply to the ownership by such bank holding company of such property by reason of subsection (c) (5) of such section.

(d) NONEXEMPT PROPERTY.—For purposes of this part, the term "nonexempt property" means—

(1) obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not exceeding 24 months, exclusive of days of grace;

(2) securities issued by or guaranteed as to principal or interest by a government or subdivision thereof or by any instrumentality of a government or subdivision; or

(3) money, and the right to receive money not evidenced by a security or obligation (other than a security or obligation described in paragraph (1) or (2)).

(e) BOARD.—For purposes of this part, the term "Board" means the Board of Governors of the Federal Reserve System.

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84TH CONGRESS
2d Session

SENATE

REPORT
No. 1308

AUTOMATION AND TECHNOLOGICAL CHANGE

REPORT

OF THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

TO THE

CONGRESS OF THE UNITED STATES

JANUARY 5, 1956.—Ordered to be printed

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71006 WASHINGTON : 1956

JOINT COMMITTEE ON THE ECONOMIC REPORT

(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

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84TH CONGRESS } SENATE { REPORT
2d Session } { No. 1308

AUTOMATION AND TECHNOLOGICAL CHANGE

JANUARY 5, 1956.—Ordered to be printed

Mr. DOUGLAS, from the Joint Committee on the Economic Report, submitted the following

REPORT

[Pursuant to sec. 5 (a) of Public Law 304 (79th Cong.)]

The following report of the Joint Committee on the Economic Report was prepared by the Subcommittee on Economic Stabilization, composed of Representative Wright Patman, chairman, Senators Joseph C. O'Mahoney and Arthur V. Watkins, and Representatives Augustine B. Kelley and Jesse P. Wolcott. The report of the subcommittee was approved for transmission to the Congress by the full committee on November 25, 1955, and will be given further consideration by the committee in connection with its report on the 1956 Economic Report of the President. The findings and recommendations presented in this report are based upon the subcommittee's recent hearings and study of the impact and prospective impact of automation and of technological change on the economy.

Introduction

Since the Joint Committee on the Economic Report is charged under section 5 (b) of the Employment Act of 1946 with the responsibility of making continuing studies of matters relating to employment, production, and purchasing power, the committee directed its Subcommittee on Economic Stabilization to study the impact of so-called automation on long-run employment and investment levels (S. Rept. No. 60, 84th Cong., 1st sess., p. 6). In keeping with this responsibility, the subcommittee looked into the current and prospective significance to the economy of rapid technological change through a series of public hearings and case studies.

During intensive hearings covering 9 days with 15 separate morning or afternoon sessions, the subcommittee heard from well over a score of witnesses closely associated with production and industry on the side of both management and labor, together with experts in the field of technology and economics.

Along with information submitted to it by various interested parties, the subcommittee heard expressly from Dr. A. V. Astin, Director, National Bureau of Standards; William W. Barton, president, W. F. & John Barnes Co., Rockford, Ill; Joseph A. Beirne, president, Communications Workers of America; Dr. Cledo Brunetti, director, engineering research and development, General Mills, Inc.; Dr. Walter S. Buckingham, Jr., Georgia Institute of Technology; Dr. Robert W. Burgess, Director, Bureau of the Census; Dr. Vannevar Bush, president, Carnegie Institution of Washington; James B. Carey, president, International Union of Electrical, Radio, and Machine Workers; Ralph J. Cordiner, president, General Electric Co.; Howard Coughlin, president, Office Employes International Union; Ralph E. Cross, executive vice president, the Cross Co., Detroit; D. J. Davis, vice president, manufacturing, Ford Motor Co.; John Diebold, John Diebold & Associates; M. A. Hollengreen, president, Landis Tool Co., Waynesboro, Pa., president National Association of Machine Tool Manufacturers; S. R. Hursh, chief engineer, Pennsylvania Railroad Co.; W. P. Kennedy, president, Brotherhood of Railroad Trainmen; Don G. Mitchell, president and chairman of the board, Sylvania Electric Products, Inc.; James P. Mitchell, Secretary of Labor; Marshall G. Munce, vice president, York Corp., York, Pa., chairman, industrial problems committee of the National Association of Manufacturers; James J. Nance, president, Studebaker-Packard Corp.; Dr. Edwin G. Nourse, former Chairman of the Council of Economic Advisers, vice chairman, Joint Council on Economic Education; Clifton W. Phalen, president, Michigan Bell Telephone Co.; Otto Pragan, research director, International Chemical Workers Union; Walter Reuther, presi-

dent, Congress of Industrial Organizations; John I. Snyder, Jr., president and chairman of the board of directors, U. S. Industries, Inc.; Robert C. Tait, president, Stromberg-Carlson division, General Dynamics Corp.; Dr. Thomas J. Walsh, professor of chemical engineering, the Case Institute of Technology, Cleveland.

These hearings, it should be noted, have been the first congressional recognition of this important postwar trend called automation, which has had and promises to continue to have a great effect upon our lives and the operations of the economy in the future.

The subcommittee appreciates and is gratified by the statement of the Secretary of Labor, James P. Mitchell

> * * * that these hearings are contributing very significantly to a broader understanding of the great technological forces that are shaping our national life and economy, and I compliment the committee on its management of them.[1]

In the course of the hearings, the subcommittee considered specifically six different industrial situations in the metalworking, chemical, electronics, transportation, and communications industries, together with data processing and officework. These industries were selected merely as illustrative of the kind of problem which may be faced in the trend toward automation. There are, of course, many other industries which might have been studied with interest and profit had time permitted. The fact that these particular industries were chosen should not for a moment obscure the fact of rapidly advancing technology in other areas. To mention only a few such areas, one might cite the canning and bottling industries. One might cite also petroleum refining, the processing of commercial-bank paperwork, the basic steel industry, the use of ready-mixed concrete, coal mining, the use of electronically controlled elevators in our modern skyscrapers, and numerous others.

No study of automation would, of course, be complete without recognition of the important and overwhelming role which technology and scientific thinking play in the development of our instruments of defense. This defense use must always be in the background but, since the joint committee's primary interest lies in civilian employment and the civilian segment of the economy, the subcommittee did not take up defense applications except in an indirect way.

In hearing persons who have had experience in the selected industries, the subcommittee sought light on the broad economic and social implications of rapidly advancing technology and know-how. Specifically it sought information on (1) the extent of possible and probable displacement of personnel, (2) the possible shifts which may arise in the distribution of mass purchasing power, (3) the distribution of the expected gains in productivity, (4) the effect upon our business structure, and (5) the effect upon the volume and regularity of private investment.

While it was impossible for all members of the subcommittee to be in attendance at all times during the hearings, careful consideration of the transcript suggests that findings and some modest recommendations are appropriate at this time. Under the circumstances, what might have been normal differences in emphasis have been passed over in order to present as large an area of agreement as practical in this

[1] Automation and Technological Change, hearings before the Subcommittee on Economic Stabilization of the Joint Committee on the Economic Report, 84th Cong., 1st sess., p. 262.

report. The findings and recommendations, the subcommittee thus believes, are sufficiently well founded in the evidence presented to it that they can be accepted generally by all who give thought to the need for progress with stability in the economy.

Findings

I

The economic significance of the automation movement is not to be judged or limited by the precision of its definition.—While it is hardly a duty expected of a congressional committee to formulate, once and for all, a definition of a new word that is not yet in standard dictionaries, there is an obligation upon anyone studying the mysteries of automation to make clear precisely what it is that is being talked about, as well as report upon what has been found under the microscope. As plans for the hearings on automation advanced, it became increasingly clear that the word means widely varying things to different people. The subcommittee has consequently used the term broadly. It has been used to include all various new automatic and electronic processes, along with rapid technological advance and improved know-how generally. One may be taking some liberties, it is true, with a yet undefined term to extend it to cover printed circuitry—etched wiring on a plastic board—and the solution by machine of the "most abstruse nonlinear partial differential equations" (hearings, p. 444), but the effect of such operations upon the economy of the future is just as real, and just as full of implications, as an improved mechanical arm for moving materials about from one machine to another.

If one has to have a short, dictionary-type definition, one witness, closely associated with the man most often credited as having been the originator of the term "automation," defined it for the subcommittee as "the automatic handling of parts between progressive production processes" (hearings, p. 53). In a sense, automation clearly is not at all new. Witnesses at the hearings vied with each other at citing an "earliest" example. One critical word in the definition just stated is, of course, "automatic." So long as one understands that machines and processes can be automatic, more automatic, and still more automatic, one can accept automation as an old concept and merely an extension of familiar forms of mechanization. A somewhat more precise definition might emphasize that the essential element in modern automation appears to be the introduction of self-regulating devices into the industrial sequence through the feedback principle whereby electronic sensing devices automatically pass information back to earlier parts of the processing machine, correcting for tool wear or other items calling for control.

In popular usage, the word "automation" has, however, come to mean much more than mere automatic material handling or the refinement of assembly-line techniques.

While, in the interests of precision, there is a natural inclination to narrow the term, it is clearly wrong to dismiss automation, however, as nothing more than an extension of mechanization. We are clearly on the threshold of an industrial age, the significance of which we cannot predict and with potentialities which we cannot fully appreciate.

Working under forced draft, our physical and chemical scientists during the war pushed the frontiers of pure and applied science far, far ahead. That effort continues, little slackened. We are consequently on the threshold of an age which will witness the peaceful use of the atom, enormously increasing the amount of available energy; the development of electronics greatly increasing our ability to control machines; and the output of modern computing machines greatly multiplying man's ability to do mental work. What, too, one may ask, of the age of solar power or of "transistors"—another word not yet in standard dictionaries. The potentialities of such forces taken collectively cannot help but raise automation far above the level of merely advancing mechanization as we have known it. As Gen. David Sarnoff has said:

> The very fact that electronics and atomics are unfolding simultaneously is a portent of amazing changes ahead. Never before have two such mighty forces been unleashed at the same time (hearings, p. 101).

We have certainly not yet seen the full impact of these new technologies. It may be expected, moreover, that the capital and research invested in their advancement will only begin to be felt in the years ahead. The "lead time" of research and investment is always long. The evidence before the subcommittee suggests, therefore, the importance of public policy looking ahead 3 to 5 years or longer when the fruits of accelerated technological advancement and postwar investment begin to accumulate and compound. We don't know what all this will add up to, but we might very well be wrong to think of it as simply "more of the same" technology which has always characterized American industry.

II

The shift to automation and the accelerated pace of technological change is today taking place against the background of relatively high employment levels and of a prosperous economic situation.—Under such conditions, dislocations and adjustments tend to be less painful. Any significant recession in levels of employment and economic activity might very well create new problems and greatly magnify the adjustment pains growing out of increased mechanization. After all, the challenge to the economy in the maintenance of reasonably full employment involves a great deal more than simply finding new positions for those displaced, whether by automation or other cause. Without giving any regard to changing rates of individual participation in the labor force, our work force is increasing at the rate of more than three-quarter million workers each year. If it should become apparent that automation is, on balance, lessening the job chances of these new entrants into the labor force, the appraisal of its significance would have to be greatly revised.

III

One highly gratifying thing which appeared throughout the hearings was the evidence that all elements in the American economy accept and welcome progress, change, and increasing productivity.—This flexibility of mind and temperament has been a conspicuous characteristic of American industry for generations in well-known contrast to that of many other countries. Not a single witness raised a voice

in opposition to automation and advancing technology. This was true of the representatives of organized labor as well as of those who spoke from the side of management. Certainly none of the evidence available before the subcommittee supports a charge that organized labor opposes or resists dynamic progress. Labor, of course, recognizes that automatic machinery lessens the drudgery for the individual worker and contributes greatly to the welfare and standard of living of all.

The fact that representatives of organized labor are watchful lest the material gains of automation become the sole objective, without recognizing the individual hardships that may be caused by job losses and skill displacements, ought not to be turned into a charge that labor, as such, is obstructive to new developments. Whenever one has been in a position to have witnessed firsthand the hardships experienced by the skilled and older worker in any line of endeavor—industrial or professional—suddenly wrenched from his job by the installation of a new machine, or new technology, one can scarcely be unmindful of the inequities which can come about where management and public policy have not given recognition to needs for retraining, relocation, severance pay, and other programs which tend to soften the transition.

Both organized labor and management are apparently aware of and intent upon seeing that these human elements are not disregarded.

IV

Along with automation and the introduction of laborsaving machinery and techniques in some parts of the economy, whole new industries have arisen and may be expected to arise.—The electronics industry, for example, is today made up of hundreds of companies, both large and small, which have sprung up all over the country, employing ever-increasing numbers. The production of specialized transfer machinery for use in the metalworking industries is another instance of an essentially new, growing industry. In some measure these new industries with their employment-giving opportunities do tend to offset the possible losses of employment in other industries where new automatic processes are being introduced. There can be little doubt but that these industries will continue to contribute toward maintaining employment levels in the future in the face of increased automation elsewhere, and even in the particular industries themselves. On the other hand, it would be unwise as a matter of public policy to overemphasize the employment potentials in these new industries and assume that their growth will be sufficient to take care of displacements in the older industries.

In the nature of things, it is almost inevitable that these newest of industries should grow up to be highly automated, employing the most advanced methods, unhampered by tradition, existing plant, and the like. In general, the pattern in these industries has been either to move product and process forward simultaneously or, quite frequently, move from the development of a new automated process to a product, rather than the more familiar search for a better way to make a known old product. The subcommittee was told, for example, that the introduction of automatic handling in chemical processes has

about reached the limit so far as known products and currently operating processes are concerned, but that intensive research on the development of new processes is certain to make new products possible. This leads us directly to another of the subcommittee's findings.

V

One fact not always sufficiently appreciated, however, is the extent to which goods and services not previously available or possible are made possible by the introduction of automatic processes.—In this connection, one must think not only of whole new items but of greatly improved goods and services as well.

Perhaps the most conspicuous case involves atomic energy and atomic isotope technologies. In these cases, the very nature of the materials to be dealt with are such that they could never have been harnessed by hand methods and close human contact. The subcommittee's attention was called to a similar situation involving polyethylene, which has become a commonplace product today around the house in the form of packaging, squeeze bottles, and the like. Production of the basic material in this case is almost completely automatic because of the need for precision of timing, worker safety, and the desirability of making the product at extremely high pressures.

The mass production of color television turns upon the development of automatic processes for placing literally hundreds of thousands of separate and individual colored dots upon the face of a picture tube, a task all but beyond human capabilities for precision and tolerance for tedium.

The new products which flow out of the availability of electronic computing machines even include the promise of better weather forecasts for the future. Without rapid mechanical computation made possible by high-speed computers, it heretofore has been difficult to make full use of all available weather data in time for it to be of use. The control of airline and railroad travel reservations is another chore which it is expected that computers will do more expeditiously.

It would be impossible here to undertake a listing of all of these products of services, the very existence of which is dependent upon the development of automatic ways of dealing with their production. The subcommittee does feel, however, that this is an important item to be chalked up on the credit side of the ledger in any appraisal of automation.

VI

While the employment potentials in these new industries themselves may not be as high as they would seem at first thought, the subcommittee was impressed with and, indeed, would be remiss if it did not draw specific attention to, the employment possibilities arising out of the service industries associated with many of these new products.—For every employee counted as employed in television manufacturing, countless local television repairmen, scattered in every city and hamlet of the Nation, depend for their livelihood on the mass production and mass distribution of the television sets produced by automated industry.

Personnel displacement resulting from increased mechanization in an automobile factory, while affecting, perhaps adversely, the lives of

the individuals immediately involved, may well be small when compared with the enormous number of crossroads garage mechanics, service-station operators, salesmen, etc., who back up the ever-expanding automobile-manufacturing industry. We are often reminded that unemployment directly caused by automation is partially offset by new employment in the machine-making industries. This is no doubt true. Far more persuasive, however, as an offset to reduced employment as a consequence of mechanization, are the opportunities offered by these diffused, less concentrated, less conspicuous, and less vocal associated service industries.

VII

While the degree of automation made possible by modern science may well surpass the limits of present imagination, it is important to note that not all workers, indeed, only a relatively small, although conspicuous, fraction of the total labor force will be directly involved.—Certainly it must be expected that increasing numbers of workers will feel the impact of automation. At the same time, large numbers of individuals in the professional and service industries, while it may be hoped can work with improved tools and instruments, will not be significantly affected by added automation, however it may be defined. The same will be largely true of those in trade, finance, entertainment, government—of purchasing agents, shipping clerks, salesmen, actors, and bus drivers.

VIII

However much we may welcome the fruits of advancing technology—however optimistic one may be that the problems of adjustment will not be serious—no one dare overlook or deny the fact that many individuals will suffer personal, mental, and physical hardships as the adjustments go forward.—The middle-aged worker particularly, who may find his skills rendered obsolete overnight or his job abolished as his work is turned over to a machine, has every right to expect that industry, his union, and society will recognize his plight and assist in his retraining, or his relocation if necessary.

The plight of these displaced workers is particularly serious when they have devoted a lifetime to an industry which itself has passed its youthful growing period and is declining relative to other industry. The hardships of the displaced middle-aged and older workers are, of course, not limited to the automation case. This is only one aspect of the general problem of superannuation—a condition found in all occupations and professions and peculiar to none of them.

IX

The most disturbing thing which came to the subcommittee's attention during the hearings was the near unanimous conclusion of the witnesses that the Nation is faced with a threatened shortage of scientists, technicians, and skilled labor.—One may be willing to pass over lightly the expert testimony that there are plants in Western Europe that are "more highly automatic than anything we have got in this country" (hearings, p. 66), even in the automotive business. But we can certainly not dismiss lightly the generally accepted evidence that

professional engineers are currently being graduated at a rate nearly twice as fast in Russia as in this country, and that technicians are currently being turned out at 30 or 40 times our rate. This evidence is not to be taken as necessarily indicating that our science and capacity for technological advancement have been surpassed elsewhere. It must, however, be taken as a plain warning that others can catch up with us and, indeed, at current rates, are doing so. The president of the Carnegie Institution of Washington, Dr. Vannevar Bush, summed up the problem for the subcommittee:

> We already have a shortage in this country of skilled men of various sorts. We also have a shortage of engineers and scientists. And not enough men are entering these fields. It has been brought out in these hearings that Russia is in some ways doing a better job in this regard than we are; they are certainly training more scientists and engineers (hearings, p. 616).[3]

It is, of course, generally accepted that the short-run retraining and salvaging of the skills of those whose livelihood is threatened by automatic machinery should be a first cost upon industry and the particular company itself. Technological change cannot be regarded as progress at all if it is not able to pay its own way, not merely in the junking of old machinery but by giving due recognition to the human costs of retraining and readjustment.

But the larger and longer run problem is that the Nation recognize the need for keeping up and advancing its resources in the form of trained experts in every field. The training problem exists at all levels. Dr. A. V. Astin, Director of the National Bureau of Standards, in expressing grave concern over this situation said:

> I think that the critical area is the high-school level and it is primarily high-school teachers. I don't think we pay our high-school teachers enough, and I don't think we can get teachers who will inspire people to take up science and engineering as a career unless these people themselves are sold on it, and, with the great shortage we now have of scientists and engineers, it is difficult to get anyone with any competence to do the teaching in the high schools at the present time (hearings, p. 587).

Under our traditional system of education, the first responsibility for this must fall upon the local communities and the individuals and business directly interested in specific kinds of skills and expertness. Many companies are already demonstrating their awareness of this problem by providing in-training technical courses and by endowing and supporting company fellowships and advanced education.

There are important reasons why this need for increased attention to the training of experts should be underscored and recognized as a real problem. The fact is that much of the knowledge and personnel upon which we are drawing so heavily today comes as a by-product of the military background of the past decade. Under the necessity of war and defense expenditures, the Federal Government has contributed immeasurably to the building up of a comfortable

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[3] After the close of the hearings a report of the National Science Foundation entitled "Soviet Professional Manpower," by Nicholas DeWitt, gave statistical substantiation to indications that in technical fields the number of Russian graduates currently exceeds those in the United States.

The report concludes: "* * * we must bear in mind that during the last two and a half decades the Soviet Union has made enormous strides towards building up its specialized manpower resources. As a result of its efforts, it has reached a position of close equivalence with or even slight numerical supremacy over the United States as far as the supply of trained manpower in specialized professional fields is concerned. The Soviet effort continues. Our own policies in the field of education and in regard to specialized manpower resources will decide whether within the next decade or so the scales will be tipped off balance" (p. 257).

present supply of trained personnel. This is all well and good, but none of us want a situation to arise in which we must depend upon war or defense expenditures as the means to securing such beneficent by-products. Industry and the colleges themselves must take over and give adequate civilian support to technical education.

In many ways the question is not simply one of Federal support or no Federal support. It is a question of finding and accepting a peacetime program to take the place of in-service training of technicians, the war-accelerated and militarily sponsored college programs, and the later support and encouragement of education afforded by the so-called GI bill of rights.

Some 20 million persons now in civil life have been in the Armed Forces and a large part of these were given specific forced-draft training of some kind. A far larger number, by the use of or the sheer closeness and rubbing elbows with highly developed modern instruments, became familiar with technologies which, under other circumstances, would have been reserved for specialists. As Dr. Vannevar Bush pointed out to the subcommittee, there are in this country today thousands of young men to whom the design of what would once have been fabulous devices is not only possible but a pleasure. They can simply take off the workshop shelf a combination of cheap reliable gadgets with which they are already familiar and whose "queer ways" are already fully understood by them (hearings, p. 613).

This great pool of knowledge cannot be regarded as inexhaustible or self-replenishing. The dangers of its depletion deserve the fullest attention of all in making sure that high-school and college training are made possible for young people with demonstrated ability and aptitude so that the Nation and the economy as a whole can continue to profit by the fruits of knowledge.

X

The trend toward automation will bear watching to make sure that it does not add to troublesome pockets of local unemployment.—The problems of local distressed areas—of chronic or short-run local unemployment—arise from a variety of causes, such as the exhaustion of raw materials, shifts in markets, obsolescence, the impact of imports, etc. It will be ironic and regrettable if the advancement of technology had to be added to the list. Whatever the causes, the distressed area problem is one with which the Nation and the Congress must feel genuine concern.

When we are told, for instance, that automation in Detroit means unemployment in South Bend, Ind.—when we know that such progressive steps as the dieselization of the railroads are partly responsible for persistent unemployment in such localities as Altoona, Pa.—when it appears that automation, by speeding obsolescence of northern cotton mills contributed to a major shift in the location of that industry—it is imperative that industry itself, with the sympathetic support of labor, must develop specific and concrete programs to ease the problems of adjustment. To the extent that those directly involved fail or are unable to cope with the problem, the Federal Government may find it expedient and desirable to assist local people to find solutions to these problems rather than risk their spreading to larger areas of the economy.

XI

The impact of automation upon the structure of our business society and the relative position of large and small business is a matter of utmost concern.—While the subcommittee had this question constantly in mind, the evidence presented is, unfortunately, not conclusive. There can be little doubt but that large business may find some advantage. The realization of the gains of automation are often dependent upon large initial investment in plant and equipment and result in the mass production and necessity for mass selling of more or less standardized units. On the other hand, there was considerable testimony to the effect (1) that smaller, less expensive models and adaptations of automated machinery will in due course become available, and (2) that relatively small business may be in a position to turn its disadvantages into an element of strength by capitalizing upon its comparative adaptability and flexibility. While big business fights for mass markets, smaller business may capture the business left behind. While big business concentrates on mass assembly, the manufacture of components and parts—even the mass production of components—becomes the opportunity for small new enterprises. There is no doubt that the smaller plants will need to give especial study to product design and standardization problems in order to achieve longer product runs and secure the maximum benefits from automatic machinery.

Small business unquestionably has its problems in the contest for survival. These include the terms of competition, the difficulty of securing sufficient capital, adequate management, and the problems of research and development. The trend toward automatic machinery may result in making these difficulties even greater, but it is far from clear that automation itself is going to add a wholly new and overwhelming set of survival problems of its own.

XII

In a dual role, as workers on the one hand and consumers on the other, we can, as a consequence of automation, have a choice between added leisure and added products and comforts.—One question which recurred frequently throughout the hearings involved the prospects for a shorter workweek within the next decade. The prevailing workweek in manufacturing today, as is well known, is about 40 hours per week compared to about 45 in the mid-1920's and about 60 at the turn of the century. The hope is frequently expressed that the fruits of automation may permit us to reduce this still further, to 30, 32, or 35 hours per week in the not too distant future. Perhaps, instead of stemming from hope, the same prediction stems in many cases from fear, that we cannot keep our labor force fully occupied if machines continue to take over parts of the work.

Whether the prediction rests upon hope or fear, the important thing for all to recognize is that we will have a choice to make. The possibility of a shorter workweek certainly ought not to be thought of as a necessity or palliative measure in making a reduced amount of work go around. It is, on the contrary, a great opportunity for mankind to choose between leisure and, one would hope, well-spent leisure, or the physical products and services which could not otherwise have been

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except for greater reliance on better machines and increased productivity.

For the most part, the industrial witnesses who appeared before the subcommittee were of the view that new and better products would so intrigue the consumer demand that we would see little near-term shortening of the workweek. Some, indeed, foresee a distinct shortage of labor supply as likely if the expected demands for new goods are to be fulfilled. Representatives of labor, on the other hand, while recognizing that such a choice may have to be made, were rather more inclined to the view that a continuing and marked shortening of the workweek is in prospect.

While the subcommittee is confident that the American public will make the right choice in this respect, it is not always going to be easy. Enlightened collective bargaining can make a contribution. As a society, we shall have to give thought making sure that the gains of productivity and the shortening of the workweek are sufficiently generalized so that those in trades and places remotely removed from automated manufacturing lines may come in due time to share in gains whatever the choice may be. There is also something of an ethical challenge which cannot be neglected in our choice. We do still have in this country substantial groups of comparatively underprivileged and lower income groups who should be remembered before those in the more favored industries can conscientiously turn to a shortened workday or longer weekend.

XIII

The introduction of automatic procedures and advanced technology, along with the problems and benefits which come from them, is not limited to the industrial portion of our economy.—State and local governments, and the Federal Government as the largest of them all, must take advantage of the opportunities for increased productivity. At the same time, responsible authorities in Government must at all times try to see that the Government is itself a model employer in its handling of the personnel and human problems involved. When, in the interests of economy and efficiency, the Government finds it necessary to displace faithful employees from their old positions, the problems of retraining, reassignment, severance allowances, must not and cannot be ignored.

The subcommittee had its attention called to several instances in which layoffs and adjustments were being made even during the comparatively short time while its hearings were in progress. It was not possible, nor is it the function of this committee, to go into the merits of these cases and the details as to their handling, but the subcommittee does feel that every effort should be made to keep the position of Government in this respect at a high level which will serve as a model for other personnel management.

XIV

These hearings will not have been in vain if, in arranging for them and hearing the many helpful witnesses, a feeling of social consciousness about the problem has been stimulated.—It is easy for those in business who are absorbed by cost reduction to forget that automatic

production, if it means fewer and fewer jobs and a disregard of human costs and hardships, will in the end be damaging to the foundations of our free society.

The genius and industry which create and boast of "thinking machines" cannot and ought not to be allowed to shift all or portions of the problems created by them to the shoulders of Government and labor. While most industrialists, by their willingness to consider these problems with the subcommittee, have demonstrated understanding of the social responsibility of free business, the subcommittee has, unfortunately, found evidence that some of those busy in advancing the technical side of laborsaving machines are still apparently unaware of the overall significance which their activities have to the economy. Government, of necessity and by public demand, is concerned with levels of unemployment, with the impact of technological changes upon our business structure, and with the maintenance of mass purchasing power. Enlightened businessmen are concerned about these things also.

Recommendations

1. The best and by far the most important single recommendation which the subcommittee can give is that the private and public sectors of the Nation do everything possible to assure the maintenance of a good, healthy, dynamic, and prospering economy, so that those who lose out at one place as a consequence of progressive technology will have no difficulty in finding a demand for their services elsewhere in the economy.

2. At this stage of the investigation, no specific broad-gage economic legislation appears to be called for, and the very good reason for this is that we already have on our statute books the Employment Act of 1946. The subcommittee can only recommend that the spirit and objectives of that act continue to be given active instrumentation and support by the executive agencies, the Congress, and the people as a whole.

3. The subcommittee recommends and strongly urges that the Federal executive agencies, the appropriate committees of the Congress, the State and local governments, and all others involved take very seriously to heart the need for a specific and broad program to promote secondary and higher education, to the largest extent possible.

4. The subcommittee similarly recommends that the Federal executive agencies, the Congress, and especially the local areas themselves develop comprehensive and concrete programs to ease the problems and eliminate local pockets of chronic or short-run unemployment, whatever the cause or causes of distress may be.

5. While Government presents a special situation it too must be alert to secure the benefits of advancing technology and increasing productivity. At the same time, in the interests of making the Government a model employer, the subcommittee suggests that the executive departments and agencies and the respective committees of the Senate and House dealing with civil-service administration would do well to keep especial watch over the problems of personnel administration involved in the displacement of employees by machines and improved techniques.

6. In the interests of labor mobility and facilitating the shifts involved in automation, the subcommittee recommends that consideration be given by the executive departments and, if need be, by the Congress to measures which will make for greater effectiveness and increased usefulness of the United States Employment Service, especially in dealing with the problem of the middle-aged worker and the placement of those of higher skills and degree of specialization.

7. From its own experience with such data, this subcommittee joins in what is certain to be a primary interest of the Statistics Subcommittee of the Joint Economic Committee; namely, the improvement of economic statistics, especially those relating to productivity and occupational shifts, and an increased alertness on the part of the executive agencies to the responsibility of providing statistics for policymaking in business as well as in Government.

8. The subcommittee recommends that industry, and management for its part, must be prepared to accept the human costs of displacement and retraining as charges against the savings from the introduction of automation. In saying this, the subcommittee is not unmindful of—and was, indeed, gratified by—the extent to which enlightened management is already aware of and accepting responsibility in this respect. Nevertheless, by careful planning and scheduling, the adjustments of workers and the stoppage of employment can be minimized and due recognition should be given to the timing of investment and technological changes with an eye on the state of general business and the needs for increased employment.

9. Organized labor should continue to recognize that an improved level of living for all cannot be achieved by a blind defense of the status quo. The education of its members, of management, community leaders, and Government officials, such as has been provided by these hearings, is an important function of union responsibility.

10. Throughout these hearings many witnesses have presented thoughtful and thought-provoking recommendations upon which the subcommittee has not had an opportunity to formulate definitive conclusions. In addition to the above recommendations, we commend to industry, labor, Government agencies, and State legislatures alike the study of this record and these individual suggestions, in order that the benefits of automation may be maximized and its hardships minimized.

11. Finally, the subcommittee's investigation convinced it that the problems of automation are by no means negligible nor settled. This prompts the subcommittee to the view and the urgent recommendation that all interested parties should make this a subject of continuing or recurrent study. The Subcommittee on Economic Stabilization considers it to be its responsibility and intends to review regularly the progress of technological change and the statistical evidence of occupational shifts. This is being done for the purpose of keeping informed and of being in a position to recommend further legislation if it should be needed.

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2d Session
SENATE
REPORT
No. 1309

1955 REPORT ON ECONOMIC STATISTICS

OF THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

TO THE

CONGRESS OF THE UNITED STATES

JANUARY 5, 1956.—Ordered to be printed

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JOINT COMMITTEE ON THE ECONOMIC REPORT

(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

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1955 REPORT ON ECONOMIC STATISTICS OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT

JANUARY 5, 1956.—Ordered to be printed

Mr. DOUGLAS, from the Joint Committee on the Economic Report, submitted the following

REPORT

[Pursuant to sec. 5 (a) of Public Law 304, 79th Cong.]

The following report of the Joint Committee on the Economic Report was prepared by the Subcommittee on Economic Statistics, composed of Representative Richard Bolling, chairman, Senator John Sparkman, and Representative Henry O. Talle. The report from the subcommittee was approved for transmission to the Congress by the full committee on November 30, 1955, and will be given further consideration by the committee in connection with its report on the 1956 Economic Report of the President. The findings and recommendations presented in this report are based upon hearings and studies conducted by the subcommittee during 1955.

I. Introduction

The Subcommittee on Economic Statistics, in accordance with responsibilities assigned to it by the full committee (S. Rept. No. 60), has worked this year in three major areas. One of these assignments involved an examination of a series of studies, which we were especially fortunate in having already going forward when the year began, on statistics of inventories, savings, consumer expectations, plant and equipment expectations, and general business expectations. These appraisals were being conducted by task forces of distinguished consultants appointed by the Board of Governors of the Federal Reserve System pursuant to a request this subcommittee made in our progress report of last year (H. Rept. No. 2628). The reports of these consultant committees were presented to the subcommittee and publicly released in five hearings held July 19 and 26 and October 4 and 5. Panel discussions were held on those days with the members of the five consultant committees in order to review their findings and give opportunity for expression of views by the individual experts.[1]

Another area which the full committee asked the subcommittee to examine deals with current and proposed programs of statistics of employment and unemployment. Hearings were held November 7 and 8 to discuss the development and adequacy of the current programs in the field of employment and unemployment statistics with the heads of the Government departments charged with collecting and processing such statistics.[2] The efforts which have recently been made by these agencies to improve the quality of their statistics were reviewed and the need for additional data or improvements in techniques examined in light of the Joint Economic Committee's use of such data.

The findings and recommendations of the subcommittee in respect to the hearings held on the Federal Reserve Board consultant committee reports and on employment and unemployment statistics are presented in sections II and III of this report.

During the year the subcommittee, aided by the staff, also continued its intensive review of the monthly publication Economic Indicators. Improvements resulting from this review, which was undertaken with the cooperation of the Council of Economic Advisers and the Bureau of the Budget, were completed in the July 1955 issue of Economic Indicators. Beginning with that issue, a new arrangement of charts and tables was also presented. With the cooperation

[1] Hearings on Reports of Federal Reserve Consultant Committees before the Subcommittee on Economic Statistics, Joint Committee on the Economic Report, July 19 and 26, October 4 and 5, 1955 are available from the Superintendent of Documents, Washington 25, D. C.

[2] Hearings on Employment and Unemployment Statistics before the Subcommittee on Economic Statistics, Joint Committee on the Economic Report, November 7 and 8, 1955 are available from the Superintendent of Documents, U. S. Government Printing Office, Washington 25, D. C.

of the Office of Statistical Standards of the Bureau of the Budget, work was completed during the year on the 1955 edition of the Historical and Descriptive Supplement to Economic Indicators. The supply of the first edition was quickly exhausted after it was first issued in 1953, even though nearly 6,000 copies were ordered for sale by the Superintendent of Documents. The 70-page 1955 edition of the supplement, which was distributed to the committee and went on sale November 2, is having an equally favorable reception.[3]

As part of one of its continuing activities, the Subcommittee on Economic Statistics released on August 22 a summary statement on appropriations for the Government's statistical programs for the fiscal year 1956.[4] This statement, which was prepared by the Office of Statistical Standards of the Bureau of the Budget, was based on special analysis I, Federal Economic Statistical Programs, which was developed at the request of the Subcommittee on Economic Statistics for inclusion in the President's annual budget.

The subcommittee has found this type of presentation to be most helpful and looks forward to the inclusion of such an analysis in the President's budget for fiscal 1957. We are gratified by the final congressional action taken on the program as set forth in the President's budget, especially the inclusion of provisions for improving the sample and dependability of our overall employment and unemployment data, improvements in related data on key aspects of current employment changes, and the collection for the first time in a number of years of comprehensive data on farmers' costs and living expenses.

At the same time we find it most unfortunate that no funds were provided for improvement in construction statistics. One of the most important forces in our current prosperity has been the continued high level of construction. In any appraisal of the economic outlook it is essential to know as much as possible about the health of this industry. Failure to provide any of the requested improvements leaves us with inadequate and scattered data which reflect only long-term trends or the largest changes in construction activity. Funds were also denied for certain improvements in our national income series and the analysis of business trends which are also essential to current economic analysis.

In view of the very real need for this additional statistical information for sound and timely decision-making it is to be hoped that a greater understanding for the need of these series by the public and the Congress will lead to a favorable consideration in the next Congress of the budgets for construction and business trends statistics and other needed improvements.

II. Studies by Federal Reserve Consultant Committees

The Joint Committee on the Economic Report has long been interested in the provision and maintenance of adequate and accurate economic data for public and private policymaking. In furthering this interest, the committee in its report on the 1954 Economic Report of the President directed the establishment of a continuing subcommittee on economic statistics. This subcommittee, under the chairmanship of Representative Henry O. Talle, held hearings in

[3] On sale by the Superintendent of Documents, Washington 25, D. C., for 40 cents a copy.
[4] See appendix B, p. 19.

July 1954, on the adequacy of economic statistics and filed a unanimous report with the full committee. The subcommittee report, which was subsequently submitted to the Congress by the full committee (H. Rept. 2628), included the following recommendation:

> 9. *The Federal Reserve System might well expand its statistical collection and analysis programs where it has special interest and competence.*—The subcommittee is requesting the Federal Reserve to explore, in cooperation with executive agencies, the adequacy of present statistics in three basic areas: (1) Inventories; (2) savings; (3) consumer and business expectations.
>
> This request includes a thorough review of and basic research into concepts, existing data, sources and procedure for improving these statistics.

On December 14, 1954, the Board of Governors of the Federal Reserve System notified the subcommittee that the recommendation was acted upon favorably. Five consultant committees of outstanding analysts were established by the Federal Reserve Board to carry out the requested studies and were asked to try to complete their findings by June 30, 1955.[5]

Each of these task forces of consultants has been made up of people who use economic statistics intensively, either in public or private affairs, and in many instances are also experienced in dealing with the problems of compiling information. In addition to developing their own collective judgment, the consultant committees surveyed in various ways the needs of active users of this type of information in business and other private organizations, universities, and governments. The subcommittee has been deeply impressed with the very practical and immediate needs which users indicated they have for improved and expanded data. We have also been particularly impressed with the degree to which the consultant groups were cost conscious. There were repeated statements and evidence that these distinguished experts deliberately restricted themselves to recommendations which could be justified on the basis of minimum costs for a maximum of results in the most vitally needed directions.

The reports of the five consultant committees organized by the Federal Reserve Board at the request of this subcommittee contain many recommendations for improvements in both public and private economic statistics. (See Summary of recommendations, appendix A, p. 9.)

Our specific recommendations based on these studies are divided into two groups: Those which can be, and should be acted upon at once; and those to be developed and put into operation over the next several years. Some of these improvements can be accomplished within present budgets. Where additional funds are required, we recommend that the Bureau of the Budget make every effort to include such funds in the President's budget for consideration by the Appropriations Committees of the Congress at this coming session.

RECOMMENDATIONS ON IMMEDIATE NEEDS

We strongly recommend immediate action on the following steps to bring economic statistics into line with minimum pressing needs, both public and private. (Page references to a summary of the consultant committees recommendations contained in appendix A of this report are noted after each of these recommendations.)

[5] Copies of this correspondence are reproduced in the Hearings on Reports of Federal Reserve Consultant Committees, pp. 5-8.

Inventories, shipments and orders.—Reliable current information on business inventories is an essential element in analyzing economic changes in such areas as output, employment, credit, and prices. Business inventory information was found to be widely recognized by analysts in business, academic, and government positions as of the utmost importance in the shaping of public policies, including monetary and fiscal policies and other policies directed toward economic stabilization and growth; and many business policies, including investment plans as well as current buying and production programs.

We recommend:

(1) The monthly Industry Survey of the Office of Business Economics, covering manufacturers' inventories, shipments, and orders should be strengthened, as for example, through introduction of a new sample design, adequate to reduce errors, to reduce present overlapping between industries, to provide finer detail, and to secure market groupings as well as present industry groups (p. 10).

(2) The Census Bureau's monthly series on retail and wholesale sales and inventories should be enlarged and improved, so as to obtain broad coverage and provide inventory data by market categories corresponding to those for manufacturers (p. 11).

(3) The Federal Reserve statistics on department stores should be expanded to include outstanding orders for major departments and seasonally adjusted data by major departments should be published (pp. 11 and 12).

Business plant and equipment expenditure expectations.—Statistics on business plant and equipment expenditure expectations are among the best known indicators of business conditions and prospects. Improvements in this area of economic intelligence are particularly important since the data reveal not merely what has happened but foreshadow what may happen to one of the most dynamic elements in the economy in the foreseeable future. Data of this type have hence become of great importance not only to those engaged in gaging the possible future course of the economy as it may affect the outlook for individual businesses, but also for those of us who are concerned with the problems of maintaining maximum employment, production, and purchasing power in accordance with the objectives of the Employment Act.

We recommend:

(1) A new monthly series on new orders, shipments, and unfilled orders for capital equipment should be developed to complement data secured in the monthly Industry Survey (p. 13).

(2) The basic data on current construction activity should be improved with immediate action concentrated on the areas revealed in our hearings of July 1954 and incorporated in the President's budget of January 1955. (These are largely the same areas noted in the consultant committee report. This is a minimum program and would still leave room for additional improvements to bring data in this area up to fully adequate standards of reliability.)

(3) The sample coverage of the SEC-Commerce data on anticipated plant and equipment expenditures should be expanded to fill the more significant gaps, and to take care of the constant sample bias by sampling new firms at regular intervals (p. 14).

Savings.—Users report that adequate statistics of savings are needed because they provide most important information on the sources from which our economy's growth is financed and the channels through which the funds flow. As the task group for this area reported—

> * * * In the private area, saving statistics are of particular value in determining investment policies and appraising availability of funds from the capital market. In the field of public policy, saving statistics are of importance in the formulation of tax, monetary, and credit policy, in debt management, and in the operation of social welfare programs.

We recommend:

(1) The responsibility for developing programs in the field of savings statistics and their sponsorship should be lodged in one place within the Federal Government but the actual compilation should be continued on the present decentralized basis (p. 14).

(2) Savings data, as well as other important statistical series, should be improved through extension of the FTC–SEC quarterly Financial Reports, now limited to manufacturing, to cover trade and other types of corporations, and through institution of financial reports for a sample of unincorporated businesses (p. 15).

Surveys of consumers and business expectations.—The two consultant committees which surveyed consumer and business expectations data seem to have been inclined to approach their task with some skepticism as to the value of the surveys. Certainly this was true in the field of business expectations. Both these groups, however, came to similar conclusions; namely, that repeated surveys of consumer and business expectations hold such great promise for providing information which will enable better forecasts to be made regarding economic trends and the effect of economic policies and programs that the expansion of data in these two fields is warranted, justifying expenditure of additional funds, both public and private, for these purposes. The statistical surveys of consumer and business expectations should include more frequent and inclusive interim surveys; and should make greater use of reinterviews or resurveys of identical firms or households to check the results of the surveys, to obtain evidence as to reasons for failure to carry out expressed intentions; and to explore means of reducing "response errors" (pp. 16 and 17).

While it was not included in the recommendations of the consultant committee, we suggest that the agencies involved consider providing survey results in the late fall of the previous year rather than the spring of the year covered by anticipations, either by retiming of surveys, if feasible, or by making preliminary surveys prior to the present operations in January and February of each year.

RECOMMENDATIONS ON LONGER RUN NEEDS

The grouping of the following recommendations under a longer run program reflects the technical difficulties involved and the developmental work required to carry them out rather than any evaluation of them as less important or less pressing. They are therefore recommended not for a dusty shelf of a distant tomorrow but as areas in which work should begin immediately so that the final steps can be carried out when technically feasible.

(1) Studies should be undertaken of (*a*) means for estimating the proportion of inventories and associated data that are defense related; (*b*) needs for, and costs of, current statistics on inventories other than in manufacturing and trade; (*c*) means of meeting needs for measures of physical volume of inventories both in aggregate and in selected detail.

(2) In the field of savings, effort should be directed at (*a*) segregating incomes, expenditures and savings for at least four main groups—nonfarm households, farmers, unincorporated business firms, and private nonprofit institutions—all now included in the aggregate figures for the so-called personal sector; (*b*) developing current data on the gross as well as net savings by type; and (*c*) developing a sources-and-uses-of-funds statement on a quarterly basis, at least for the corporate sector.

(3) The National Science Foundation should investigate the possibilities of a program of research grants for studies recommended by the five task forces as particularly promising.

(4) The need for promptly available facts on the related aspects of consumer behavior being great, the Budget Bureau should review the various federally sponsored programs in the field to see specifically how data on consumer stocks, expenditures, finances, and anticipations might be collected most efficiently and made more adequate for present uses.

(5) The possibilities for developing new and earlier anticipatory statistics on business spending should be explored by the appropriate agencies.

We commend to the attention of the Office of Statistical Standards, the Bureau of the Budget, and the respective executive agencies other recommendations of the five consultant committees which we have not specifically mentioned above. These recommendations constitute the collective judgments of some of the outstanding experts in their respective areas and are deserving of serious consideration. We request that the Bureau of the Budget report to this subcommittee at the end of this fiscal year, or before, as to the progress of their review and any actions which have been taken concerning the recommendations of the five task groups.

RECOMMENDATIONS ON PRIVATE STATISTICAL PROGRAMS

In addition to our recommendations regarding Government statistics we recommend that private groups undertake to increase their contributions to our national system of economic intelligence. To this end we commend to them the various recommendations of the five subcommittees concerning the activities of private agencies in these fields. We specifically recommend for their consideration and action:

(1) Increased support for and coordination of work on the measurement of business expectations, perhaps through a single body backed not only by those working in the field, such as Dun & Bradstreet and McGraw-Hill, but also by users groups from business, industry, financial institutions, labor unions, etc.

(2) Increased support for surveys of consumer expectations.

(3) Efforts to develop ways to more fully utilize and coordinate statistical work of trade associations, to provide data of general

usefulness without undue burden to the associations and possibly at some saving to the public.

(4) Research projects by doctoral candidates and others, assisted where necessary by foundation grants, along lines suggested in these task force reports.

(5) Organization of a continuing private group interested in all aspects of the measurement and interpretation of business and consumer expectations to act as a clearinghouse for information and as sponsor of conferences of experts where methods can be appraised and research results reviewed.

III. Employment and Unemployment Statistics

The Joint Committee on the Economic Report, through this subcommittee and in hearings and reports of the full committee, has expressed a continuing interest in the adequacy of all economic statistics. But there are few, if any, statistical series which are studied and analyzed with more care and interest than those dealing with employment and unemployment. It is imperative that these series be as sound as possible and that there be a maximum of confidence in their reliability.

In the first general hearings held by the Subcommittee on Economic Statistics on July 12 and 13, 1954, a number of steps were outlined for improvements in major statistical areas including employment and unemployment. The President's budget for fiscal 1956 carried requests for funds to carry out many of these improvements, most of which were granted. A brief series of hearings to learn from representatives of the Government departments charged with collecting and processing employment and unemployment statistics the kind of improvements they already had underway or were planning in connection with their programs for 1956 was included in the plans for this subcommittee's activities during the year.

We have been much impressed with the many steps outlined in the testimony which these representatives presented during these hearings which were held on November 7 and 8. We have been equally impressed with the free and frank statements of deficiencies which still exist and the proposals by the agencies to correct these deficiencies as far as their personnel and funds would permit.

We also commend the studies on the problem of concepts, definitions, and comparability of data which have been carried out by the Subcommittee on Review of Concepts of the Interagency Committee on Labor Supply, Employment and Unemployment Statistics. These materials were prepared by technicians who know well not only the problem of concepts and definitions but the everyday problem of collection and presentation of their data. The Subcommittee on Economic Statistics is most interested in following through with the operating departments their final actions on the Interagency Committee report.

The subcommittee is especially concerned that, as we develop our concept of the labor force, adequate account be taken of shifts in the patterns of employment. The concept of the labor force now in use is a great improvement over the techniques developed during the depression. At the same time, we point out the need for making sure

that we are reducing as far as possible any tendency to underestimate the problem of unemployment in periods of depression or recession.

As was announced at the beginning of the hearings, and in the subcommittee's press release of November 6, it is the desire of the subcommittee to solicit written comments on the materials presented at the employment and unemployment statistics hearings from a selected group of interested organizations and individuals. We look forward to further analysis of the departmental presentations after these detailed comments have been received.

IV. Recommendation for Further Committee Study

Our recent hearings have revealed again that a principal use of economic data by private users as well as public agencies is in preparing quantitative economic projections as an aid in policymaking. Some of these projections are more in the nature of unconditional forecasts, while others are statements of the probable outlook on the basis of stated assumptions. The need for quantification of projections has been emphasized on many occasions. Only by such efforts can economists and policymakers adequately review previous economic analyses in a scientific way. Improved economic projections can contribute to economic stability, and a survey of economic projections and methods for making them should be of great value. As a first step, we recommend that during 1956 a survey be made by the subcommittee of procedures and methods used by Government agencies, for example, in projecting Government revenues and expenditures by the Treasury Department and the Bureau of the Budget, in preparing and disseminating outlook materials by the Department of Agriculture, in estimating the following year's construction activity by the Departments of Commerce and Labor, and in coordinating such work by the Council of Economic Advisers.

Hearings conducted this fall by four other subcommittees of the Joint Economic Committee have revealed areas of deficiencies in our statistics which the subcommittee will wish to consider further—with a view to incorporating additional recommendations for study or action in the committee's next annual report.

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APPENDIX

Appendix A

Summary of Recommendations of Consultant Committees on Economic Statistics Sponsored by the Board of Governors of the Federal Reserve System at the Request of the Subcommittee on Economic Statistics[6]

Recommendations of the Consultant Committee on Inventory Statistics

GENERAL RECOMMENDATIONS

1. We recommend that agencies compiling inventory statistics review the instructions now given to respondents and, where necessary, make them more detailed and specific with respect to (*a*) the nature of the figures desired, and (*b*) the information to be supplied by the respondent regarding the nature of the figures reported.

2. We recommend exploration of the possibilities of securing assistance from interested professional organizations in obtaining information on current accounting practices for inventories and in developing standards for reporting inventory information.

3. We recommend that agencies compiling inventory statistics explore intensively all potential means of speeding publication of the figures and adopt those for which the gains in time are commensurate with money and other costs.

4. We recommend that agencies compiling inventory statistics review their present descriptive material and, where necessary, modify it to provide, in accessible form, detailed descriptions of the purposes, nature, methods, limitations, potential errors and appropriate applications of the data; that they revise the descriptions as frequently as necessary to keep them up to date; and that they refer to such descriptions in all current releases.

5. We recommend that agencies compiling related sets of inventory statistics work closely together to avoid differences in results not due to differences in purposes; and that they provide clear explanations in their descriptive material of the nature and significance of differences related to purposes, with as close an approach to full statistical reconciliation as is feasible without undue cost.

6. We recommend that agencies compiling inventory statistics publish periodically lists of all releases on inventories or employ other devices to insure that users are familiar with all the information developed on the subject by the agency; and that agencies compiling monthly or quarterly figures make tabulations of back data readily available to users, preferably in pamphlets also including descriptive material.

[6] Excerpt from Hearings on Reports of Federal Reserve Consultant Committees.

7. We recommend that Government agencies compiling inventory statistics strive to integrate their efforts more closely with those of private statistical organizations engaged in similar work by offering technical advice and assistance, by undertaking to provide benchmark data for additional selected monthly series compiled privately, and by exploiting privately produced data in Government compilations to the maximum extent warranted by their nature and quality.

8. We recommend that the appropriate Government agencies actively explore the possibilities of partial or complete financing by private groups of new Government compilations of inventory and related information; that they undertake such compilations where arrangements can be developed which are agreeable to both parties and equitable to others whose interests are affected; and that results of such compilations—as well as other compilations—be made available to anyone outside the Government be made simultaneously available to the general public, except where national security considerations are involved.

9. We recommend that appropriate arrangements be made to provide the necessary strong leadership and guidance to the Government's work in the field of inventory data.

RECOMMENDATIONS ON VALUE DATA—MANUFACTURING

10. We recommend that a new sample be developed for the monthly Industry Survey of the Office of Business Economics, covering manufacturing inventories, sales, and orders. The new sample design should be adequate for the purposes discussed in this report and strenuous efforts should be made to achieve and maintain high response rates, including personal visits where necessary.

11. In view of the very considerable proportion of inventories reported to the Internal Revenue Service on a basis other than the calendar year, we recommend review for each industry group of the advisability of using these data as benchmarks for the monthly Industry Survey and, where feasible and necessary, appropriate modification of adjustment procedures. We shall recommend below (No. 14) that the Census Bureau's Annual Survey of Manufactures be used in place of Internal Revenue Service figures for annual benchmark purposes in the Industry Survey; the recommendation here is intended to apply only until such a change is made.

12. We recommend with respect to the Industry Survey that overlapping between manufacturing and nonmanufacturing and among manufacturing industry groups be reduced; that finer detail for significant subgroups and industries be developed; and that efforts be made to develop a "market" grouping of the data supplementary to the industry grouping. The market grouping should be in terms of the following categories, with such further product differentiation within categories as may prove feasible: finished manufactured goods, subdivided into producers' equipment, consumers' durable goods, and consumers' nondurable goods; and unfinished manufactured goods, subdivided into construction materials and unfinished goods destined for further manufacture. Recommendations Nos. 13 and 14 are made to help achieve these ends, which will also be served by recommendation No. 10 above.

13. We recommend that negotiations be conducted with selected manufacturing companies chosen by prior analysis of diversification

in company activities, with a view to determining the types of detail they can readily provide on a monthly basis. Arrangements should be made for the regular submission of such detail where it will facilitate attainment of the stated objectives.

14. We recommend that the data of the Census Bureau's Annual Survey of Manufactures, rather than of the Internal Revenue Service's Statistics of Income, be employed for annual benchmark purposes in the industry survey. This change in the source of benchmark information is preferred to the modification in adjustment procedures recommended in No. 11 above; the earlier recommendation is intended to have effect only as long as the use of Internal Revenue Service data may be continued.

15. We recommend that studies be undertaken of means for estimating the proportion of manufacturers' inventories and associated data that are defense-related. If feasible, estimates should be published at times when high levels or changes in level of defense activity make such information particularly significant.

RECOMMENDATIONS ON VALUE DATA—TRADE

16. We recommend an expansion of the scope of the inventory data collected in the Census Bureau's monthly Wholesale Trade Report to include manufacturers' sales branches and other nonmerchant wholesalers, in addition to the presently covered merchant wholesalers.

17. We recommend that the "kind of business" categories of the Standard Industrial Classification, such as "dry goods," "drugs," and "paper" wholesalers, be continued as one basis for classifying wholesale inventory and related data, but that when feasible this be supplemented by a grouping of the figures for wholesalers into "market" categories corresponding to those described for manufacturers. (See recommendation No. 12.)

18. We recommend that a regular annual survey of wholesale trade be instituted, similar to the one conducted by the Census Bureau for 1953 but covering nonmerchant as well as merchant wholesalers.

19. We recommend that the scope of the Census Bureau's monthly Retail Trade Report, which now covers sales of all types of stores and inventories of chainstores, be expanded to provide inventory data for independent retail stores other than department stores.

20. We recommend that the "kind of business" categories of the Standard Industrial Classification, such as "grocery stores," "department stores," and "lumberyards," be continued as one basis for classifying retail inventory and related data, but that when feasible this be supplemented by a grouping of the figures for retailers into "market" categories corresponding to those described for manufacturers. (See recommendation No. 12.) In this supplementary grouping, data for department stores should be distributed to the appropriate market categories.

21. We recommend that the Federal Reserve statistics for department stores by major department, which now cover stocks and sales, be expanded to include data on outstanding orders for selected departments or groups of departments of general analytical interest.

22. We recommend that, for selected departments or groups of departments of general analytical interest, the Federal Reserve department-store data on sales and stocks by department, and the data (pro-

posed in recommendation No. 21 above) on outstanding orders by department, be published on a seasonally adjusted basis as well as without seasonal adjustment.

RECOMMENDATIONS ON VALUE DATA—OTHER SECTORS

23. We recommend that further studies be made by an appropriate agency of the needs for, and the cost of, current statistics on book values of inventories for sectors other than manufacturing and trade.

RECOMMENDATIONS ON VALUE DATA—INTERNAL REVENUE STATISTICS

24. We recommend that beginning-of-year and end-of-year inventory figures be included regularly by the Internal Revenue Service in the planned alternate-year tabulations of Statistics of Income data for noncorporate business.

25. We recommend that end-of-year corporate inventory figures now tabulated by the Internal Revenue Service in Statistics of Income be supplemented by tabulations of the reported beginning-of-year inventories from the same returns, to assist users of inventory and other data in dealing with problems of changes in the degree of consolidation and classification of companies in the Statistics of Income data.

26. To help implement recommendation No. 11 above, we recommend that the Internal Revenue Service make tabulations of the volume of manufacturing corporation inventories, classified by major industry group, according to the fiscal periods to which the data relate. Such tabulations would be of value also for other purposes.

RECOMMENDATIONS ON VALUE DATA—GROSS NATIONAL PRODUCTS STATISTICS

27. We recommend that the significant intermediate results of the calculations culminating in the published GNP series on change in business inventories be regularly published at a time and to the extent warranted by improvements in the basic data employed. Pending publication of these intermediate results we recommend that each quarterly release of the GNP inventory change figure be accompanied by a brief note explaining the relationship between the GNP inventory change figure and OBE book value data for manufacturing and trade, and including a summary statistical reconciliation of these data.

28. We recommend that to the extent feasible on the basis of available data and consistent with national security considerations, net changes in selected categories of Federal Government inventories be shown in the GNP tables as a component under "Government expenditures."

RECOMMENDATIONS ON PHYSICAL VOLUME DATA

29. We recommend that a pilot program of study and experimentation be undertaken by appropriate agencies with a view to meeting needs for physical volume measures of inventories at aggregate levels and in selected detail as expeditiously as possible. Areas in which study may be usefully initiated are specified in the three following recommendations.

30. We recommend that attempts be made to improve the information available for deflating inventory value figures by obtaining additional information about (*a*) accounting practices, turnover rates, and other factors influencing the values assigned to individual commodities in business accounts; (*b*) the appropriateness of available price information for inventory deflation; and (*c*) feasible means of securing additional reports of prices paid for goods in stock for use in inventory deflation.

31. We recommend that experiments be undertaken in constructing physical volume indexes for significant broad sectors or types of products. These should be initiated on the basis of existing physical volume data for individual commodities and any data collected in accordance with recommendation No. 32 below. Such experiments would help to indicate the additional data needed for more satisfactory measures. Experimental indexes may well make some use of deflated value information, where data in physical units cannot yet be obtained.

32. We recommend that studies be made of the feasibility of developing satisfactory physical volume inventory and related data for individual commodities of outstanding importance, and for significant sequences of commodities at several stages of fabrication and distribution. Initial studies might properly be concerned with inventories of steel and textiles in various positions, and the sequence following them, since fluctuations in production, consumption, and inventories of these commodities are often of great significance to the economy.

Recommendations of the Consultant Committee on Business Plant and Equipment Expenditure Expectations

EQUIPMENT PURCHASE EXPECTATIONS

1. A new monthly series should be developed on orders, shipments, and unfilled orders for capital equipment.

2. The desirability should be explored of compiling quarterly forecasts of new business by capital equipment producers.

3. Also deserving of exploration are the possible advantages and the feasibility of a series on new authorizations for capital commitments.

PLANT CONSTRUCTION EXPECTATIONS

1. Improvements should be made in the reporting of building permits so as to extend coverage and develop more accurate estimates of the real cost of proposed work. The lag in publication should be reduced.

2. Special surveys should be made of anticipated expenditures for construction by State and local government bodies and by public utility companies.

3. Private contract reporting agencies should be encouraged to carry on improvements in their data and should be urged to adopt the classification system used by the Department of Commerce.

4. Encouragement should be given to efforts to develop data on future construction from reports on work in the planning stage in architects' offices.

5. A study should be made of the feasibility of obtaining data on mortgage loan commitments from lending institutions as a means of obtaining information on anticipated construction.

PLANT AND EQUIPMENT EXPENDITURE EXPECTATIONS

1. The sample coverage of the data on plant and equipment expectations should be expanded to fill in the more significant gaps, and the desirability of modifying blowup procedures should be investigated.
2. Detailed tests should be carried out periodically to check the predictive accuracy of the data.
3. Special surveys should be conducted to study the factors affecting the predictive accuracy of the data, as well as factors affecting investment decisions generally.
4. The feasibility of providing additional breakdowns of plant and equipment expenditure expectations should be investigated, with initial emphasis on improving the available data segregating plant and equipment.
5. The desirability of altering the timing of collection of the annual survey data on expectations, and changing the period covered by the quarterly data, should be explored.
6. The predictive value of longer term capital programs, i. e., those covering more than 1 year, should be further studied.
7. Finally, it is recommended that an exploratory survey of farmers' intentions to invest in plant and equipment be carried out to determine the value of such information to supplement the available data covering nonagricultural business.

Recommendations of the Consultant Committee on Statistics of Savings

Provision of sustained leadership presents a more difficult problem which is aggravated by the fact that statistics of saving generally are only a byproduct and minor activity and hence sometimes a stepchild of the different agencies that produce them. The committee, therefore, recommends that the responsibility for formulating and developing programs in the field of saving statistics and their sponsorship be lodged in one place within the Federal Government—not necessarily in one of the agencies now producing statistics of saving—but that the actual compilation of statistics be continued on the present decentralized basis. It is beyond the committee's responsibility to suggest the exact form which such arrangements could or should take, but the principle of centralization of responsibility is, in the committee's opinion, essential to the realization of its objectives.

PERSONAL SAVING

Of the statistics now available in the field of personal saving, further development and expansion of the estimates of aggregate saving and its components by the balance-sheet approach (used, e. g., by the Securities and Exchange Commission) give most promise of meeting the demands of business, government, and university users. To permit intelligent analysis of the figures, much more of the underlying data, as well as detailed descriptions of methods and sources, should be currently made available to users.

Monthly indicators of saving.—In addition to the present quarterly and annual statistics, a set of monthly indicators of personal saving

should be developed. They would not be as comprehensive or as elaborate as the data now made available, but could be released within 3 to 4 weeks after the end of the month.

Saver groups.—(1) The statistics of personal saving need to be presented separately—in the aggregate and by components of saving—for at least four groups of savers—nonfarm households, farmers, unincorporated business firms, and private nonprofit institutions—all of which are now commingled in one aggregate for personal savings.

(2) Among the steps which should be explored in effecting this separation is the breakdown, on the basis of institutional records, of items like saving through bank deposits, savings and loan associations, life insurance, United States savings bonds, and common stocks.

(3) Of the different groups of savers, the saving statistics of unincorporated business firms are most urgently in need of thorough improvement. This may require development of current financial reports from a sample of such firms.

Forms of saving.—(1) Need for improvements in the statistics is greater for saving through real estate other than 1- to 4-family dwellings, through privately held mortgages, and through securities that are not distributed by the investment-banking machinery.

(2) Some forms of saving not now segregated should be shown separately, particularly saving through private pension funds and pension funds of State and local governments.

(3) Estimates should be provided of personal saving in the form of consumer durables.

(4) The statistics should show, wherever possible and relevant, the gross flows of funds involved in the saving process—e. g., purchases and sales of a given type of security—rather than only the net balance of transactions.

(5) Saving through retirement of outstanding debt should be estimated separately from dissaving in the form of incurrence of new debt, particularly in the case of mortgage debt.

(6) Contractual forms of saving, including contractual debt repayment, should be shown separately in the statistics.

Sample surveys of household saving.—While these surveys hold out great promise for a better understanding of saving practices of households, considerable additional experimentation will be required before the value of survey data as supplements to measures of aggregate saving can be regarded as established. This will call for a number of special studies designed to test reliability of the data and to explain apparent discrepancies with estimates of saving from other sources. These studies are particularly needed for households in the upper and very low income groups.

CORPORATE SAVING

The estimates of sources and uses of funds, which are now available only on an annual basis for all nonfinancial groups together, should be developed to the point where (*a*) they can be put on a semiannual and later a quarterly basis; (*b*) figures are available separately for major industry groups; and (*c*) they can be presented separately for large, medium-sized, and small corporations. Probably the most promising approach is the expansion of the Quarterly Financial Reports, now collected by the Federal Trade Commission and the Securities and

Exchange Commission for manufacturing corporations, to include corporations in trade, mining, and service industries, and possibly in construction and real estate, and the collection of similar data for different groups of public utility and financial corporations with the assistance of the supervisory agencies.

GOVERNMENT SAVING

Estimates should be prepared on the saving of Federal, State, and local governments along methods parallel to those now applied to the saving of households, corporations, and unincorporated business firms. This will involve the segregation of capitalizable expenditures (separating those of military character) and the development of depreciation allowances for the different types of tangible assets owned by the Government. Once these figures are at hand, estimates of aggregate national saving, not yet available on a consistent basis, will become possible.

Recommendations of the Consultant Committee on Consumer Survey Statistics

If no appreciable increase in the present budget for the Survey of Consumer Finances is feasible, we recommend:

1. That the Survey Research Center regularly draw half of its sample for the Survey of Consumer Finances from the sample of the previous year and thus secure reinterview data for testing both expectational and memory statistics.

2. That periodic conferences be held with respect to the scope, methods, and analysis of the Survey of Consumer Finances. University research workers and users of survey data from the fields of business, labor, and agriculture might well be invited to participate.

3. (*a*) That the Federal Reserve Board or the Survey Research Center make special arrangements with particular research centers to undertake analytical research on survey data;

(*b*) That procedures be established to provide research workers with adequate access to survey data, and in view of the fact that a similar problem confronts many Government agencies, that a committee of the American Statistical Association study the problem of how to make original data of Government agencies more readily available to research workers.

4. That the surveys provide data that are comparable over as long a period as is feasible.

5. That published data be accompanied by indications of sampling errors whenever feasible, and that a detailed discussion of sampling errors be made available to technical users.

6. (*a*) That the interim survey use a sample that overlaps in whole or in part the sample of the previous Survey of Consumer Finances;

(*b*) That the questions on expectations, intentions, and attitudes be consistent in the two surveys;

(*c*) That statistics from the interim surveys be republished as part of the reports on the Survey of Consumer Finances;

(*d*) That the published reports of the interim surveys include relevant data from the annual surveys.

7. That the Bureau of the Budget and the agencies engaged in conducting surveys cooperate to eliminate avoidable inconsistencies and to explain justifiable differences in the various survey statistics.

We believe that additional Federal and private funds can usefully be spent on consumer surveys, but it is not our province to suggest how much. Additional expenditures for the Survey of Consumer Finances and related surveys can usefully be incurred for—

1. A larger and more stratified sample.
2. More frequent and inclusive interim surveys.
3. More extensive reinterviews.
4. More inclusive publication of survey results.
5. More complete financial data.
6. More information concerning stocks and acquisition of durable goods and houses.
7. More analysis of results and experimentation in methods.
8. More checks on accuracy of survey results.

Recommendations of the Consultant Committee on General Business Expectations

TRUING UP OF EXISTING DIRECT EXPECTATIONS SERIES

1. Present survey organizations should make a serious effort to include a substantial element of before-and-after data from identical firms. This recommendation is directed in the first instance to compilers of expectations data, but collectors of historical data (e. g., inventories) should also consider the possibility of collecting expectations. Where current sampling routines do not yield a substantial overlap of identical firms, consideration should be given to special callback samples.

2. Current samples should be more fully stratified by industry and size, and sample sizes increased to the extent necessary to permit such breakdowns. Supplementary sampling should be undertaken when necessary to fill in the upper size strata of the business population. Experiments in the recombination of such breakdowns with appropriate weights to approximate the business population at large should be undertaken.

3. Compilers should recognize the need for more complete quantification of expectations data on a time-series basis. Experimentation with techniques of seasonal adjustment is also desirable, with the aim of eliminating back-comparisons with the corresponding time period a year earlier.

4. The present serious wastage of useful information should be avoided. Descriptions of survey procedures should be complete and kept up to date. Cross tabulation of data should be compiled and made available on request, if not necessarily published, on the before-and-after experiences of individual firms, the covariation of causally related items such as sales-inventory expectations, and comparisons of expectations with current levels of related variables.

FULLER ANALYSIS OF EXISTING BODIES OF DATA ON DIRECT EXPECTATIONS HERE AND ABROAD

5. An illustrative list of possible studies is presented in chapter VII, and other specific suggestions are offered in chapters III and IV, of the consultant committee report. These prospective areas of additional research appear to have the further advantage of requiring only modest resources to bring them to completion, thereby increasing their

attractiveness to educational and other institutions with limited research budgets.

6. A special survey conducted by the committee suggests the presence of untapped possibilities in data regularly compiled by trade associations. Of 437 trade associations that provide economic or statistical services for their members, three-fifths reported that they regularly assemble and disseminate information on the future prospects of the economy as a whole, of their own industry or trade, or of both. Of these, 100 professed to supply direct measures of expectations for their own industry or trade, and 38 to supply such measures for general business. The existence of paydirt in this area deserves fuller investigation than the committee was able to give it.

TRUING UP AND FULLER ANALYSIS OF INFERENTIAL MEASURES OF EXPECTATIONS

7. A thorough study, covering as long a time span as possible, should be made of the timing history, particularly at cyclical turning points, of the several inferential measures of business expectations reviewed in this report.

8. More refined classification of data should be attempted as the most promising method of segregating complicating factors in data on business births, business deaths, and new orders.

9. The 22 individual commodity prices represented in the BLS Index of Spot Market Prices might profitably be restudied to determine the extent to which the effect of supply factors could be eliminated and leads improved.

10. The following possibilities for the development of new inferential series should be investigated:

(*a*) Forward investment commitments (based, perhaps, on expansion of the series already set up for life-insurance companies).

(*b*) Bond-price differentials.

(*c*) Exploratory study for some nondurable goods industry not currently reporting new orders with the aim of developing an index that could play the role of new orders in analysis.

EFFORTS AT THE DEVELOPMENT OF NEW DIRECT-EXPECTATIONS DATA AND THE CREATION OF AN EXPLICITLY EXPECTATIONAL ECONOMICS

11. Possible new approaches to direct expectations include:

(*a*) Plans of individual firms from the comptroller point of view (cash flows planning), in contrast to the point of view of production and inventory plans.

(*b*) Regional expectations statistics such as those compiled by several of the Federal Reserve district banks.

(*c*) Systematic development of a body of data on production schedules.

12. Coordinate basic research is necessary on the techniques of business forecasting and decision making; this research should be undertaken by balanced teams representing such mutually reenforcing disciplines as economics, business practices, psychology, and sampling and interview techniques.

13. The theory of expectations developed over the past quarter century should be thoroughly reworked. In recommending simultaneous work on all three fronts—data, business practice, and theory—

we are impressed with the fact that a high payoff on any one is likely to be heavily dependent on concurrent progress in the other two and cannot be guaranteed independently of such progress.

WAYS AND MEANS FOR AN INTEGRATED PROGRAM OF BASIC RESEARCH

14. Serious consideration should be given to the organization of a continuing private group interested in all branches of expectational economics (similar perhaps to the Conference on Research in Income and Wealth), with collaboration of experts on field surveys, group decisions, etc.

15. Funds for such research might well be provided from private sources, but public interest may also warrant Government support, particularly for the truing up of existing private series.

16. Among other objects, a research organization of the sort proposed should seek to place resident observers or "interns" in the various survey organizations now compiling expectations data, here and abroad, and to the extent feasible, in business enterprises as well.

APPENDIX B

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D. C., August 12, 1955.

HON. RICHARD BOLLING,
Chairman of the Subcommittee on Economic Statistics of the Joint Committee on the Economic Report, House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: In reply to your request of August 9, I am enclosing a summary showing final 1956 appropriations for major Federal economic statistical programs. We have also shown the extent to which the expected increases were granted. This summary has been prepared by our Office of Statistical Standards, and includes all the programs described in Special Analysis I of the 1956 Budget Document.

We appreciate the continued interest of the Joint Committee on the Economic Report in the development of the Government's statistical program.

Sincerely yours,

ROWLAND HUGHES, *Director.*

FINAL 1956 APPROPRIATIONS FOR FEDERAL ECONOMIC STATISTICAL PROGRAMS

Final appropriations for fiscal year 1956 allowed increases totaling $2,616,000 for current economic statistical programs, as compared with requested increases totaling $4,722,000. The increases were included in the proposed 1956 programs of a number of agencies as a "governmentwide effort to improve statistics in those areas where our work has been most handicapped by incomplete information," as stated by the President in his 1956 budget message.

Areas in which improvements will be made this year as a result of the increases allowed are statistics on employment and unemployment, agricultural marketing research, estimates of farmers' expenditures, crop and livestock estimates, and the economics of farm production. Funds were added by the Congress for additional work in agricultural economics and statistics for projects which had not been included in the budget request—a study of acreage diversion, a study of the price spread between the farmer and the consumer, and establishment of a crop-reporting program in Hawaii.

No funds were allowed for the interagency program designed to improve and expand statistics on construction and housing. Other areas in which the budget requests were denied include additional data on wages and industrial injuries, development of State-by-State data on State and local government finances, and an increase for analysis of national economic trends. Reductions were made in the amounts requested for a number of other current programs and for the periodic census programs.

The 1956 budget recommendations for major statistical programs were summarized in a separate statement included in the 1956 Budget Document as Special Analysis I. Inclusion of this separate statement followed the recommendation

made last year by the Subcommittee on Economic Statistics of the Joint Committee on the Economic Report, that a section on economic statistics be included in the President's annual budget. Final action on the programs which were included in Special Analysis I is summarized below by broad subject areas. The 1955 appropriation, 1956 budget estimate, and 1956 appropriation for each of the agencies whose programs are included, in whole or in part, in this summary are shown in a separate table.

Appropriations for major economic statistical programs, by agency

[In thousands]

Agency	1955 appropriation	1956 budget estimate	1956 appropriation
Current programs:			
Department of Agriculture:			
Agricultural marketing service—Marketing research and agricultural estimates	$10,223	$10,961	[1] $11,046
Agricultural research service—Economics of production, included under "Farm and land management research"	1,369	1,469	[2] 1,557
Department of Commerce:			
Bureau of the Census	6,200	7,400	6,900
Business and Defense Services Administration—Construction statistics, included under "Industry divisions"	140	940	140
Office of Business Economics	900	1,000	900
Department of Health, Education, and Welfare: Public Health Service—National Office of Vital Statistics	1,395	1,395	1,395
Department of Labor: Bureau of Labor Statistics	5,350	6,845	6,065
Department of the Treasury: Internal Revenue Service—Statistical reporting	1,685	1,685	1,582
Federal Trade Commission: Financial reports, included under "Economic and financial reports"	133	268	193
Securities and Exchange Commission: Preparation of operational and business statistics	126	160	156
Total, current programs	27,421	32,143	29,934
Periodic census programs: Department of Commerce, Bureau of the Census:			
Census of agriculture	16,000	6,000	5,500
Censuses of business, manufactures, and mineral industries	8,430	4,655	4,000
Intercensal housing survey		500	0
Total, periodic census programs	24,430	11,155	9,500
Total, major economic statistical programs	51,851	43,298	39,434

[1] Includes $65,000 not in budget estimate, added by Congress for study of price spread between farmer and consumer and crop-reporting program in Hawaii.
[2] Includes $100,000 not in budget estimate, added by Congress for study of effects of acreage diversion on farm income and the general economy.

CURRENT PROGRAMS

Increases requested and allowed, by broad subject areas

[In thousands]

Program	Increase	
	Requested for 1956	Allowed for 1956
Employment and unemployment, wages, industrial injuries	$1,883	$1,165
Prices and price indexes	285	285
Construction and housing	965	0
Production and distribution	925	[1] 876
Population and vital statistics	100	100
National income and analysis of business trends; State and local governments	364	90
Electronic equipment development	200	100
Total, major current programs	4,722	[2] 2,616

[1] Includes a total of $165,000 added by Congress, not included in the Budget requests, for specific studies relating to agricultural problems.
[2] Difference between 1955 and 1956 appropriations for major current programs is $2,513,000, including adjustment of $103,000 in Internal Revenue Service for savings made possible through Univac.

Employment and unemployment, wages, industrial injuries.—Most of the increases requested for specific programs directed toward improvement of statistics on employment and unemployment were allowed. The increases received will make possible a significant increase in the size of the Census Bureau's current population survey and greater dependability of its labor-force data. In the Bureau of Labor Statistics the new funds will provide for additional study of the characteristics of the unemployed and the causes of unemployment; work toward a unified Federal-State statistical program on labor turnover by States and areas; development of a series on overtime hours worked in manufacturing industries; development of additional industry detail on employment, hours and earnings for selected nonmanufacturing industries; and work on a new edition of the Occupational Outlook Handbook.

Programs in this area for which increases were not allowed for 1956 include BLS proposals for extension of community wage surveys and wage studies in particular industries, an annual report on collective bargaining, expansion of work-injury statistics and accident-cause studies, and development of adequate national statistics on workmen's compensation.

Prices and price indexes.—The increase requested and received in this area will provide for a major survey by the Agricultural Marketing Service of farmers' expenditures for family living and farm production. Information from this survey will be used in determining whether the index of prices paid by farmers needs to be revised or reweighted, and also in analysis of farm income and farm practices.

Construction and housing.—No funds were allowed for the proposed program to expand and improve statistics on construction. The coordinated program was included in the budget requests of the Business and Defense Services Administration and the bureau of Labor Statistics. In addition, the request for $500,000 for an intercensal housing suvrey, included under "Periodic census programs," was also disallowed.

Production and distribution.—For the Agricultural Marketing Service, requests for further market research and improvements in the estimates of crop and livestock production were allowed, and additional funds were provided for a study of the price spread between the farmer and the consumer ($50,000) and for establishment of a crop-reporting program in Hawaii ($15,000). In the Agricultural Research Service, an increase for work on the economics of production was approved, and an additional $100,000 provided for a study of the effects on farm income and the general economy of acreage reductions imposed on 1954 and 1955 crops.

In the Bureau of the Census, less than half the amount requested for annual surveys of manufactures and of retail trade was allowed.

Population and vital statistics.—Approval was given to the request for an increase to enable the National Office of Vital Statistics to reduce the time lag in publishing reports of vital statistics.

National income and analysis of business trends; State and local governments.—Most of the increases requested in this area were denied. Part of the increase requested for the financial-reports program conducted jointly by the Federal Trade Commission and Securities and Exchange Commission was allowed, but not sufficient to provide for all the improvements requested. No increase was given to the Office of Business Economics to expedite use of the results of the business censuses now being taken in the national income-product accounts; and no increase was allowed the Bureau of the Census to develop annual State-by-State estimates of State and local government finances, to supply information needed in this area.

Electronic-equipment development.—An appropriation of $200,000 was requested by the Bureau of the Census for development of specialized electronic equipment for use in the economic censuses scheduled for 1958 and in the 1960 decennial censuses. Half of this amount was allowed.

PERIODIC CENSUS PROGRAMS

In addition to the requests for current programs, the budget estimate for 1956 included a total of $11,155,000 for periodic census programs; $6,000,000 for completion of the 1954 census of agriculture, of which $5,500,000 was allowed; and $4,655,000 for completion of the 1954 censuses of business, manufactures, and mineral industries, of which $4,000,000 was provided. The $500,000 requested for an intercensal housing survey was not allowed.

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84TH CONGRESS
2d Session

SENATE

REPORT
No. 1310

FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY

REPORT

OF THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

TO THE

CONGRESS OF THE UNITED STATES

JANUARY 5, 1956.—Ordered to be printed

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(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

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84TH CONGRESS, 2d Session } SENATE { REPORT No. 1310

FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY

JANUARY 5, 1956.—Ordered to be printed

Mr. DOUGLAS, from the Joint Committee on the Economic Report, submitted the following

REPORT

[Pursuant to sec. 5 (a) of Public Law 304 (79th Cong.)]

The following report of the Joint Committee on the Economic Report was prepared by the Subcommittee on Tax Policy, composed of Representative Wilbur D. Mills, Chairman, Senators Paul H. Douglas, Joseph C. O'Mahoney, and Barry Goldwater, and Representative Thomas B. Curtis. The report from the subcommittee was approved for transmission to the Congress by the full committee on December 27, 1955, and will be given further consideration by the committee in connection with its report on the 1956 Economic Report of the President. The findings and recommendations presented in this report are based upon hearings and studies conducted by the subcommittee during 1955. Senator Joseph C. O'Mahoney, a member of the subcommittee, was unable to participate in these hearings, studies, and this report because of the pressure of other committee responsibilities.

INTRODUCTION

In today's complex world the Federal Government is spending billions of dollars for defense and domestic programs. Without passing judgment on the proper magnitude or the nature of Federal expenditure programs, this subcommittee recognizes that the Congress has been faced in years gone by, and will be faced in the years to come, with the necessity of levying substantial taxes to finance these expenditures. While the basic purpose of taxation is to raise revenue to finance expenditures authorized by the Congress, such taxes have an important economic impact; the higher the taxes the greater the impact. It is to these economic consequences of Federal taxation that the Subcommittee on Tax Policy has directed its study.

Thus, achievement of the objectives of the Employment Act of 1946 requires recognition of the implications of Federal tax policy. Con-

stant endeavors must be made to improve the tax structure so as to minimize deterrents to economic growth consistent with the increase in the labor force and with advancing productivity. In making changes in the revenue system consideration must be given to stability of the general price level and to the full and best use of our economic resources. Improving the climate of competition is another important requisite of sound tax policy.

Pursuant to the directive of the full committee as set forth in its report to the Congress last March (S. Rept. No. 60, 84th Cong., 1st sess.), the subcommittee has focused its study on the relationship of tax policy to the attainment of the Employment Act objectives, with particular emphasis on maintaining a steady and sustainable rate of economic progress. The subcommittee recognized, of course, that other objectives of tax policy cannot be ignored in examining our revenue system.

The subcommittee has explored a wide range of tax issues in order (1) to formulate acceptable general criteria for evaluating tax policy from the standpoint of the growth and stability objectives of the Employment Act, and (2) to outline a general tax policy designed to conform to the Nation's economic requirements for the coming years.

In the course of its study, the subcommittee invited and received the assistance of 81 economists, accountants, lawyers, and other tax experts. These participants prepared papers on various aspects of the subcommittee's inquiry, which were printed and distributed to subcommittee members, participants, and the general public in mid-November in the joint committee print, Federal Tax Policy for Economic Growth and Stability. At hearings with these participants during the period December 5–16, the basic issues embraced by the study were explored and developed.

Economic Principles for Federal Tax Policy

The subcommittee has not attempted to spell out in detail specific recommendations for changes in our tax laws. This is the function of the Committee on Ways and Means in the House of Representatives and the Committee on Finance in the Senate. Rather, this report sets forth the basic standards in the light of which any and all tax recommendations should be evaluated if Federal tax policy, a major economic force, is to conform to the needs for steady economic growth. The tax policy recommendations offered herein, therefore, are necessarily broad in scope and character, and are intended to outline the course along which the Federal revenue system should develop to meet our basic standards, as well as revenue needs.

I. Federal tax policy should recognize that the level of tax revenues in relation to the amount of government expenditures has an important bearing on the level of economic activity. This would tend to result in Federal surpluses and debt retirement during prosperous and boom periods and deficits during recessions and depressions

In recent years there has been increasing understanding of the fact that the Federal Government's tax and spending programs are important factors affecting levels of economic activity. It is now generally recognized that, given the amount of Government spending, Fed-

eral fiscal policies have a significant impact on the total demand for the goods and services which can be produced by maximum employment of our resources, and that, therefore, an important objective of these policies must be to minimize fluctuations in the level of total economic activity. Such fluctuations represent significant barriers to the attainment of any long-run growth objectives; recessionary movements interrupt the process of growth by leaving some of our growing resources idle, while inflationary changes in economic activity make continued growth more difficult to maintain.

Thus, increasing taxes to maintain Federal revenue in balance with expenditures during a recession is a force toward deepening the recession. By the same token, maintaining a budget balance by reducing tax rates when a budget surplus emerges from inflationary expansion of income could serve to reinforce inflationary pressures.

Tax policy which recognizes the need for minimizing fluctuations in prices and employment is in line with a major recommendaton of the Douglas subcommittee of the Joint Economic Committee on Monetary, Credit, and Fiscal Policies in the 81st Congress:

> * * * that Federal fiscal policies be such as not only to avoid aggravating economic instability but also to make a positive and important contribution to stabilization. * * * (Monetary, Credit and Fiscal Policies, S. Doc. No. 129, 81st Cong., 2d sess., p. 1).

At the outbreak of the Korean war in 1950, following a unanimous recommendation of the joint economic committee, the Congress changed a tax-reduction bill into a tax increase bill to counteract inflationary pressures.

This view of the contribution which tax policy can make toward stabilizing the economy was reaffirmed by the joint economic committee under the chairmanship of Representative Wolcott in its unanimous report to the Congress in February 1954. The substantial tax reductions in that year were major factors in stemming and reversing recessionary trends.

On the basis of present information, the Federal administrative budget probably will be balanced and the consolidated cash budget, including trust fund accumulations, likely will show a surplus for the current fiscal year 1956. The relative stability of defense and defense-related expenditures with moderate increases in other spending programs are expected to result in total expenditures for the year of about $64 billion. Rising personal and corporate incomes, reflecting the current marked expansion of economic activity, are expected to increase total revenues to the level of anticipated spending as shown in the administrative budget, resulting, therefore, in a cash budget surplus of about $2 billion.

The prospect of a balanced administrative budget and a surplus in the consolidated cash budget raises the question of possible tax reductions early in 1956. Such action, however, should not be taken without due consideration of its effects on the economy as a whole.

It is generally agreed that the currently emerging Federal cash budget surplus is the result of the significant expansion of economic activity since the last quarter of 1954. As such, this surplus represents a check on the pace of this economic advance. Were it not for this increase in tax receipts relative to expenditures, we should probably now be witnessing a more rapid increase in the general price level.

Prices of industrial products have been rising in recent months; only the continuing decline in farm prices prevents an overall rise in the wholesale price index. So long, therefore, as the present expansionary movement continues with upward pressure on prices of nonagricultural commodities, using the developing cash budget surplus as the occasion for tax reduction would be to forego utilizing a force for maintaining a stable rate of economic growth. A tax rate reduction next year in the face of a booming economy might well be inflationary. Rather, tax policy aimed at stabilizing the Nation's economy would call for applying the surplus to reducing the bank-held Federal debt. Only in highly prosperous times such as the present are we likely to find it economically possible to reduce the level of the Federal debt. We should reduce the Federal debt during periods of boom to offset the deficits resulting during periods of recession and depression.

Of course, it must be recognized that the economic outlook may change rapidly in the coming months. It may become apparent that expansion of economic activity is slowing, and that a higher rate of increase in total demand is required to make full use of our growing productive capacity and to provide the impetus for further growth. In this event, we would be in a position to reduce taxes more advisedly than by taking the action prior to evidence of economic need. In any event, improvements in the revenue structure are always timely; the revenue effects of such revisions, of course, should be carefully weighed in the light of prevailing economic conditions.

It should be emphasized that if Federal tax policy reflects the need for avoiding both inflation and recession, the long-run possibilities for Federal tax reductions will be greatly enhanced. If we succeed in moderating short-run fluctuations in economic activity, we can count on a steady growth over the next decade which will make possible within that decade substantial reductions in effective Federal tax rates—perhaps by as much as one-third. Indeed, barring increases in Government spending programs, general reductions of tax rates will probably be necessary to assist in providing a level of total demand adequate for full utilization of all our resources. The key factor, of course, is the international situation. If, however, the world political situation does not worsen and if we have steady economic growth and price stability, prospects for substantial reductions in Federal tax rates are excellent.

II. TAX POLICY SHOULD IMPROVE THE AUTOMATIC STABILIZATION POTENTIAL BUILT INTO THE FEDERAL REVENUE SYSTEM

The responsibility of the Congress, under the Employment Act of 1946, to minimize fluctuations in the level of economic activity is a heavy one. While the Congress has in recent years shown a willingness to act promptly to meet changing fiscal requirements, there may nevertheless remain a delay between the time when the need for action first develops and when legislative action is completed. Fortunately, the revenue structure contains built-in features which tend automatically to offset inflationary and deflationary tendencies in the economy. It is recognized that these automatic stabilization features cannot fully counteract fluctuations in economic activity. Nevertheless, to the extent that these features can be strengthened, the difficulties in-

volved in congressional action to repress these fluctuations through amendment of the Revenue Code will be reduced. Accordingly, increasing the capacity of the Federal revenue system to provide automatic stabilization is an important factor in Federal tax policy.

The principal components of the Federal revenue system which automatically afford the desired compensating changes in revenues are the individual and corporation income taxes. Excise and sales taxes respond much more sluggishly to changes in national income, while estate and gift taxes respond only over time to such changes as affect property values. Employment taxes evidence only moderate sensitivity, and are necessarily hinged on the character of social-security programs, thereby restricting the scope of the adjustments which might be made. Accordingly, enhancing the built-in flexibility of the revenue system requires strengthening the individual and corporate income taxes.

The stabilizing capacity of income taxes depends primarily on (1) the size of the tax base relative to the actual income of individual and corporate taxpayers, (2) the responsiveness of the items of income which comprise the tax bases to changes in levels of economic activity, and (3) the degree of effective progression in the rate structure applied to the tax base. If we are to produce more built-in flexibility, proposals for amendment of our income taxes should be weighed in the light of their impact on these factors. Under the present individual income-tax laws, for example, only about 40 percent of what the Department of Commerce describes as personal income enters the tax base. Moreover, some of the most cyclically responsive types of income are not fully subject to the graduated rate schedule. Thus, the actual or effective progression of rates is considerably less than that indicated by the statutory rate schedule. The result is that much of the built-in flexibility of the tax has been lost. Much the same criticism may be directed against the corporate income tax. To a considerable extent this loss may be accounted for by inadequate recognition of the importance of built-in flexibility in the revenue system in evaluating proposals which may very well have been quite desirable on other grounds. For the future, the cost of any proposed revision of the income taxes in terms of possible loss of responsiveness to changes in the level of economic activity should be carefully weighed.

Strengthening the countercyclical sensitivity of these taxes involves no necessary implications with respect to the level of rates. The basic area in which this must be sought, rather, is in increasing the responsiveness of the tax bases to changes in levels of economic activity. In general, this may be accomplished by directing tax policy toward broadening the bases of the income taxes relative to the economic concepts of personal and corporate income. We call particular attention to those income items which are highly responsive to changes in levels of economic activity and which now escape ordinary income-tax treatment. Similarly, we call attention to deductions which do not contribute to accurate measurement of net income but which serve to offset fluctuations in income. At the very least, proposals which would result in further constriction of the tax base should be avoided whenever possible.

Adjustments of the tax-rate schedules to increase the responsiveness of the income taxes should also be sought. In the corporation income tax, the $25,000 surtax exemption provides a limited graduation in effective tax rates ranging from 30 percent on corporations with taxable income of $25,000 or less, to a top rate just under 52 percent. An increase in the spread between the bottom and top combined rates would contribute at least modestly to greater sensitivity of the corporate income tax.

In the individual income tax, nearly 80 percent of taxable individual returns in recent years has been subject to tax only at the first-bracket rate. For most individual taxpayers, therefore, graduation in the statutory rates is largely of academic interest only. While considerable graduation in effective rates is provided for these taxpayers by the personal exemption system, a substantial improvement in the built-in flexibility of the individual income tax might be afforded by providing additional marginal rate graduation at the bottom of the taxable income scale. Built-in flexibility would also be greatly enhanced by narrowing the taxable income brackets applicable to joint returns of married persons.

The importance of strengthening the built-in flexibility of the Federal revenue system is accentuated by the prospects for a changing relationship in Government finances in the years ahead. Barring the necessity for a significant increase in defense buildup, the Federal Government's spending programs and revenue system may well decline in importance relative to the level of total demand. At the same time, State and local government responsibilities may be expected to grow as an increasing population requires higher and higher levels of public services. We may anticipate a shift in the relative importance of Federal and State and local government fiscal operations in the coming years. Such a shift, however, necessarily entails an increasingly important role for the relatively regressive and, therefore, insensitive revenue systems of State and local governments. Despite continuing efforts at these levels of government to improve their revenue structures in line with contemporary standards of adequacy, it is recognized that the barriers to attainment of these standards permit only very slow progress. Thus, we face the possibility of an increasingly unresponsive overall fiscal system, unless determined efforts are made to strengthen the built-in flexibility of the Federal revenue structure.

III. FEDERAL TAX POLICY SHOULD ENCOURAGE THE BALANCED GROWTH OF THE ECONOMY AND THE MOST EFFICIENT USE OF OUR ECONOMIC RESOURCES

The record of the American economy since the end of World War II is an impressive testimonial to the vigor of the basic growth-generating forces in the economy. The advance of technology and the efforts of business to implement these advances, and the growth in population and the labor force with the attendant increase in consumer demand and the ability to meet this demand, have resulted in an increase of almost 40 percent in our national production at constant prices from 1946 through the 3d quarter of 1955.

This is an impressive record. In large part, it is attributable to the fact that the economy has maintained, at least approximately, the appropriate balance between the two major components of private demand, namely, consumer expenditures and capital outlays. Failure to maintain this balance makes it extremely difficult to achieve steady economic growth. Where the rate of growth in consumer demand outstrips that of investment expenditures, the rise in living standards will soon grind to a halt by reason of the failure of our productive capacity to keep up with the expansion of our consumption needs. By the same token, an excessive rate of capital formation involves not only some current sacrifice of rising standards of living, but also threatens idle capacity and disorganization and interruption of growth in productive capacity.

The Federal tax system has made an important contribution toward balanced economic growth as between consumption and investment. Some exceptions may be noted within the investment category. Several important industries have been unduly burdened and their growth repressed by discriminatory selective taxation, while others have been able to outstrip competitors because of preferential tax treatment. Lack of uniformity in the application of our tax laws has also resulted in a highly differential tax impact on various types of economic activity, often closely related in terms of basic economic characteristics. While noting exceptions of this sort, it may nevertheless be concluded that on the whole the Federal revenue system has not been significantly biased in favor of or against either consumption or investment.

No discussion of the balance between consumption and investment would be complete without recognizing the growth in recent years of public investment, particularly at the Federal level. This is not to pass judgment on the merits or the economic impact of such investment, but merely to call attention to the fact that investment may be made either through traditional private channels or through Government. In the present context, we refer to the impact of the Federal tax system on private investment.

Maintaining the proper balance in the impact of tax burdens on the growth of consumption and investment outlays, therefore, is a prime criterion of tax policy for steady economic growth. Adhering to this standard does not, however, necessarily preclude shifts in the relative emphasis placed on various components of the revenue system from time to time as the occasion warrants. Slackening in the rate of growth of the economy associated with lagging consumer demand and idle plant and equipment, for example, would suggest the need for a reduction in taxes bearing on consumption relative to other major elements of the revenue system. By the same token, should rising levels of consumption prove inadequate to induce the desired rate of growth in productive capacity, easing the relative burden of taxes falling primarily on capital accumulation would be called for.

Since such shifts in tax emphasis necessarily involve relatively heavier burdens on one or the other of the major components of private demand, the economic situation should be very carefully appraised before the shift is undertaken. Decisions in this regard must be based on careful economic analysis, rather than on the popular catch phrases which are frequently and indiscriminately attached to legislative proposals.

Moreover, balanced economic growth as an objective of Federal tax policy requires that the burden of taxes fall as neutrally as possible among all taxpayers. It has been repeatedly observed that the present Federal revenue system contains a host of special provisions, some of very restricted applicability, which provide preferential treatment with respect to certain types of economic activity. A distinction must be made in this connection between "differential" and "preferential" tax treatment. Differences in actual economic circumstances may require differential tax treatment if the tax base in each set of circumstances is to be accurately and fairly measured and, therefore, the correct tax rate is to be applied. A preferential tax provision, on the other hand, refers to treatment which involves a lighter tax burden on some taxpayers than their circumstances warrant from an economic point of view.

A common characteristic of most preferential provisions is that they tend to induce use of resources in such a way as to produce lower returns before tax and higher returns after tax than would result in the absence of the preferential treatment. In other words, these preferential provisions tend to result in resource use different from that which would result if the tax system were more nearly neutral and resource allocation were determined to a greater extent by the impersonal mechanism of the price system. But since it is commonly assumed that the operation of the price system in free markets will result in the best direction of our resources, tax provisions which interfere with such allocations must necessarily involve a cost in terms of a lower total real value for the product of the economy. This cost is reflected in restriction of the growth in productive capacity which might be attained with minimum sacrifice of current living standards.

Of primary significance in light of the objective of balanced economic growth are those special provisions in the tax laws which are aimed at stimulating the growth of some particular industry or industries. It should be recognized that use of the Federal tax system as a means of stimulating the growth of any particular industry necessarily means willingness to deter the growth of others not equally favored. The more preferential the tax treatment afforded industry A to stimulate its growth, the less can be afforded industries B through Z. Possibly some, if not all, of the latter may even have to assume greater tax burdens than formerly and therefore may encounter more substantial barriers to their growth.

If preferential tax treatment is afforded any group in the economy, it necessarily implies a value judgment with respect to the type of economic activity most essential to the process of economic growth. We must be keenly sensitive to the weight of responsibility we assume if such decisions, which traditionally we are inclined to leave to the mechanism of the price system in the market, are made. Errors in making these value judgments may prove very costly in terms of the efficiency with which scarce economic resources are used and therefore in terms of the growth in living standards and productive capacity of which the economy is capable.

Moreover, experience has shown that preferential tax provisions tend to produce chain reactions; each such provision leads to claims for similarly preferential treatment from taxpayers who do not quite qualify for the initially provided benefits. The cumulative effect of

such a process is to constrict the tax base and to reduce the extent to which economic growth may be taken advantage of for purposes of reducing tax rates.

Adjustments in the revenue system to conform with growth considerations should take the form of general revisions rather than special provisions of narrow applicability. General revisions hold far greater promise for removing the deterrents to balanced economic growth than those which attempt to obtain neutrality in the impact of taxes by providing equally preferential treatment for one narrow group of taxpayers after another.

A prime objective of Federal tax policy should be to strive for neutrality in the application of our revenue laws. This neutrality in impact will be closely approximated by providing uniform tax treatment for all taxpayers with equal taxpaying ability, without reference to the particular circumstances out of which the taxpaying ability arises.

Elimination of growth-distorting features from the tax system would entail a thoroughgoing revision of the Internal Revenue Code. While the magnitude of such an undertaking is recognized as formidable, the rewards in terms of a more dynamic and better balanced economy warrant that a start be made. Although all of the principal components of the Federal revenue system contain such distortions, attention should be focused at the outset on the individual and corporate income taxes and on excises, since these account for all but a small fraction of total Federal revenue.

Considerations of fairness as among similarly situated taxpayers as well as among different groups in the economy cannot be ignored in formulating tax policy for economic growth and stability. Fortunately, these considerations almost invariably tend to reinforce the criteria and broad recommendations for future tax policy discussed above. The inequities in the present tax system are to be found primarily in those provisions of the tax law which afford some taxpayers preferential treatment as compared with others in fact similarly situated and which serve to reduce, very markedly, progression in tax burdens. Both the need for greater built-in flexibility and for balanced economic growth and most efficient use of our economic resources suggest a tax policy which would greatly reduce these inequities. Achieving greater equity in the distribution of tax burdens and a Federal tax system which will offer the greatest encouragement to steady, sustainable economic growth, therefore, go hand in hand as objectives of Federal tax policy.

IV. FEDERAL TAX POLICY SHOULD PROTECT AND PROMOTE AN ATMOSPHERE FAVORABLE FOR SMALL AND NEW BUSINESSES

The importance of small and new businesses in preserving and strengthening a competitive market economy has long been recognized. A large number of small-business units is required to insure that control over the use of resources and therefore over output and prices is widely diffused. A high entrance rate of new businesses is required to insure the continuing challenge of established firms so essential to the development of new products and new and more economical production processes and methods.

It is obvious at the outset that every effort should be made to write simpler tax laws. The more complex the tax code, the greater the burden on small business relative to the position of larger businesses.

Recognition of the importance of small and new businesses implies a tax policy which prevents tax discrimination against such business units. In general, the principal requirement in this connection is to avoid imposing tax disadvantages on the relatively high degree of risk and venturesomeness which characterize new enterprise in particular. This criterion, however, should not be construed as calling for preferential treatment on the basis of the type of venture undertaken. The criterion, rather, should be regarded as generally applicable, suggesting the need for adequate provision for risks in the tax laws without preferentially offsetting such risks on the basis of type of business activity. This criterion also suggests the need for gearing the tax burdens of small and new businesses to any problems peculiar to such businesses in obtaining the financial resources required for their survival and growth.

A distinction should be drawn between "preferential" and "differential" tax treatment in gearing tax policy to protecting and strengthening the competitive position of new and small businesses. The needs of such businesses, and the reflection of these needs in public policy, do not call for a preferentially lighter real impact of the revenue system on such taxpayers as compared with larger, established companies. Differential tax treatment, however, may be required in order to offset a disproportionately heavy impact on small, new firms resulting from application of tax laws geared to the taxpaying ability of large, established business units.

Accordingly, this criterion calls for careful examination of tax proposals in the light of their real impact on the relative position of new and small businesses in the national economy. We should be sure that such businesses can participate equally with large, established firms in the benefits of proposed tax adjustments. Similarly, it should be recognized that, whatever its merits may be, a proposal which weakens the competitive position of small and new businesses may involve a significant cost in the effectiveness with which other public policies can achieve the free competition and atmosphere of economic challenge so essential in our economy.

In recent months, increasing attention has been focused on the rise in mergers and consolidations of corporate enterprise. While this development does not uniquely involve small businesses, their position is weakened by any tendency toward concentration of enterprise in fewer and fewer hands.

Tax considerations have been identified as playing an important role in this movement. Present law provisions with respect to loss carryovers, corporate reorganizations, and nontaxability under the income tax of gains on property transferred by gift or at death appear to be of major significance in this connection. Accordingly, the tax laws should be carefully examined and appraised in terms of their impact on the ability of small- and medium-size companies to resist inducement for absorption into larger business units.

In addition, it is a widely held view that small and new businesses have limited access to credit and equity capital from external sources, as compared with larger, better-established firms. The growth require-

ments of small and new companies frequently involve more extensive reliance on internal resources, particularly retained earnings, than in the case of other companies. A corporation income tax rate structure which does not unduly limit the financial resources required to finance the growth of large, established companies, therefore, may prove extremely burdensome in this respect for small and new companies. A greater differential in effective rates applicable to small and large corporate taxpayers should be given careful consideration.

Conclusion

The needs of the American economy for increasing capacity to provide higher living standards for all the population must be reflected in all the economic policies of the Federal Government. To be of greatest effectiveness in this respect, Federal tax policy in the future should:

(1) Be related to levels of Government expenditures by the need for full utilization of growing productive resources and stability in the general price level;

(2) Enhance the built-in stabilizing capacity of the Federal tax system by strengthening the individual and corporation income taxes;

(3) Encourage the balanced growth of the economy and most efficient use of our economic resources by maintaining a careful balance between those elements of the tax system which rest most heavily on consumption and on investment and by seeking greater neutrality among taxpayers; and

(4) Protect the competitive position of small and new businesses by providing adequate tax offsets to business risks and by gearing the structure of tax rates to any differential barriers to acquiring the financial resources required for their growth and development.

Finally, in light of the experience and benefits derived by this subcommittee through use of statistics in the course of its study, we commend to the committees of the Congress the desirability of obtaining additional data and other information bearing on the economic effects of existing tax provisions and other factors influencing balanced economic growth and stability.

SUPPLEMENTAL VIEWS OF SENATOR DOUGLAS

The report of the subcommittee is excellent on the points which it covers and it is to be commended to the Congress and the public. The chairman, Mr. Mills, stated when he assumed his duties that in his judgment the subcommittee should concern itself with the economic effects of taxation but that it should leave the formulation of specific changes in tax provisions to the Ways and Means Committee of the House and the Finance Committee of the Senate. He has held strictly and honorably to that pledge.

Although it may be quite proper for the subcommittee as a whole to refrain from recommending specific tax changes, this does not preclude individual members from offering their views. In fact, I think recommendations on the next steps in tax policy as well as specific illustrations of the very excellent general principles in the report may increase the benefits from our inquiries. I am, therefore, taking this opportunity of adding these supplementary views which are based, to a great extent, on the testimony presented before the subcommittee.

1. State and local taxation which raises about $28 billion a year, or almost 30 percent of all revenues, is significantly regressive in character. The paper by Dr. Musgrave, and the testimony by one of the ablest tax administrators of the country, Eugene A. Shaw, of North Carolina, clearly show [1] that property taxes from which seven-eighths of local revenue is obtained are imposed at higher effective rates upon the homes of the lower-income groups than upon the mansions of the wealthy or upon industrial and commercial property. Similarly, State governments derive about two-thirds of their revenue from some form of sales taxation, whether this be general sales taxes or specific excises such as a gasoline tax, a liquor or cigarette tax, or a motor-vehicle tax. These taxes are quite markedly regressive. Since expenditures for services, such as servants, health, education, etc., and savings are exempt, and since the proportion of income devoted to these purposes increases with income, this means that, as income increases, the percentage absorbed by such sales taxes and excises decreases.

2. It is therefore necessary to have a considerable degree of progression in the Federal tax structure if we are to have even a proportional distribution of tax burdens in the total tax system. But it should be remembered that we collect about $10 billion a year, or about 16 percent of the total Federal revenues from excises on liquor, tobacco, gasoline, communications, transportation, etc. These excises are regressive in nature, i. e., they bear more heavily on the poor than they do on the rich, and add to the disproportionate burden of taxation on low-income groups occasioned by State and local systems. Progression in the Federal tax structure is provided by the individual income

[1] See Federal Tax Policy for Economic Growth and Stability, pp. 96–113, 799–807.

tax—which gives only one-sixth of State but 48 percent of Federal revenues—and the corporation income tax.

The combined Federal, State, and local tax systems, therefore, impose an overall burden which, according to Dr. Musgrave,[2] is approximately proportional at income levels up to $10,000 a year and mildly progressive at higher income levels. Therefore, if taxes at all three levels of government are taken into account the overall results are quite different from the burden imposed by the Federal income tax alone.

3. At the very least, the degree of progression in the present overall Federal tax structure should not be reduced. To do so would make the combined burden of the Federal, State, and local tax structure regressive. Only somewhat cruel people can advocate such a system. It follows therefore that attempts to substitute in the Federal tax structure a general manufacturers' sales tax for a part of the income tax should be resisted. Judging from the experience of Canada, initially low excise and sales taxes are later readily increased. We should not permit the thin edge of the wedge to be inserted in our tax structure for the opening would soon be widened and deepened.

4. The highly progressive nature of the Federal income tax based on statutory rates which range from 20 to 91 percent is in fact more apparent than real. Steady erosion of the income tax base has resulted in effective tax rates far less progressive in practice than those shown in the tax schedules.[3]

There have been steady erosions of the tax base, whereby actual income has either been removed from taxation or taxed at a much lower rate. Among these erosions I would mention the following:

(*a*) The provision of split income for husband and wife produces sizable reductions in the amount of income tax which would otherwise be paid by persons with large incomes, for under this provision tax savings increase with increases in income.[4] The provision is of virtually no benefit to over three-quarters of all individual income-tax payers since their taxable income falls within the first rate bracket. The effect of this provision is a yearly revenue loss in the magnitude of $3 to $3.5 billion at the present time.

(*b*) The fact that the basic tax rate is not deducted at the source for corporate interest and dividends although it is for wages and salaries, leaves a considerable degree of tax avoidance and evasion amounting probably to between $200 and $300 million per year.

(*c*) The capital-gains tax which takes into account only one-half of the gain and subjects the gain to a maximum rate of 25 percent,

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[2] Ibid., table 2, p. 98.

[3] In 1951, for example, there were 1,697 returns by single persons and married persons filing separately which showed adjusted gross income between $100,000 and $150,000. On a dozen of these returns income subject to tax was less than $50,000. On 831 returns, or almost half, taxable income was between $50,000 and $100,000. One return showed taxable income less than $2,000. When one realizes that adjusted gross income represents income after deductions for 50 percent of long-term (6 months) capital gains and for percentage depletion, it is seen that effective rates of tax on the actual income of high income groups are far less than those indicated by the statutory rate schedule. See Internal Revenue Service, Statistics of Income, pt. I, 1951.

[4] For example, a married man with $100,000 of taxable income saves $13,680 and pays taxes of $53,640, instead of taxes at $67,320, or a savings of over 20 percent. A married man with $4,000 in taxable income saves only $40 and pays taxes of $800 instead of $840, or a savings of less than 5 percent. Thus the gains of high-income groups from the split-income provision are greater in both absolute and proportionate amounts than for low-income groups.

has resulted in the classification of a great deal of actual income as capital gains and hence, a great loss of revenue. As compared with provisions which would restrict capital gains to the sale or exchange of a capital asset rigorously defined, the revenue loss may very well be in the magnitude of $500 million.

(*d*) The depletion allowances for the extractive industries have the effect of exempting a large amount of income from taxation and lead to a less efficient utilization of the resources of labor and capital than would be true in the absence of such a tax.[5] This is particularly true of the oil industry. But it has also been extended to such extractive industries as sand and gravel, oystershells, and clamshells. The latest verifiable figures indicate that the depletion allowances amount to a little over $2 billion a year.

(*e*) Something of the same kind can be said about the preferential rates granted to incomes derived from investments in the Western Hemisphere which would otherwise be paid by foreign incorporated subsidiaries of domestic corporations.

(*f*) There is still some abuse in the field of family partnerships when income is shared with minor family members who make no real contribution to the earnings of the partnership. Tightening the law with regard to family partnerships could provide additional revenues in the magnitude of about $100 million a year.

5. The Federal estate tax has gone through a similar process of erosion. Some of the ways in which this has been done are:

(*a*) By exempting from the estate tax gifts made more than 3 years prior to death.

(*b*) By using the device of life estates to avoid payment of the estate tax on successive transfers of estates from one generation to another.

(*c*) By eliminating the premium payment test for determining whether insurance proceeds are included in the gross estate.

A conservative estimate of the revenue losses by these and other generous provisions of estate and gift taxes is in the magnitude of $500 million.

6. The effect of all these erosions is not only to lead to tax avoidance and loss of revenues but also to great injustices as between individuals and families in the same income group. One set of people who do not or cannot take advantage of these loopholes are in fact taxed at a higher rate than those in the same income class who can and do profit from these exemptions and privileges. This disparity produces a smarting sense of injustice, leads to a constant widening of the existing loopholes and the opening up of new ones, and weakens the morale of those who do continue to pay taxes. Any widening of those loopholes should therefore be resisted and we should try to gain back some of the ground which has been lost.

7. A reduction of the total tax take is always welcome, but it needs to be carefully considered in the present situation. We need to remember that communism is still a threat, that the total military strength of the Communist bloc is increasing, and that they have made diplomatic and propaganda gains during the last few months. We need also to remember the acute needs for education, public health, highways, and housing. I believe some increase in the expenditures for

[5] Federal Tax Policy for Economic Growth and Stability: See particularly the papers by Messrs. Paul, pp. 297–313, Gray, pp. 430–439, and Harberger, pp. 439–449.

these purposes would be constructive and, in the finest sense of the term, productive.

Furthermore, we should realize that there will probably be no surplus in the administrative budget in 1955–56, although there may be a surplus in the consolidated cash budget as indeed there was in every fiscal year but one from 1947–52.[6] Any surplus in the administrative budget for 1956–57, provided general prosperity continues, can more properly be devoted to a reduction of debt. If indeed we do not reduce the debt in a period of what is termed "high prosperity" when will we in fact do so?

Specific action must await economic events and business conditions. Nonetheless the best interests of the economy are served if receipts exceed expenditures in times of prosperity and if expenditures exceed receipts in times of depression or sharp recession.

8. Nevertheless, it would be wise to effect some readjustment within the general Federal tax structure whereby some loopholes would be plugged and some inequities corrected.

I would suggest as a minimum program that (*a*) the direct credit against taxes of 4 percent of dividends be repealed; (*b*) that income from corporate dividends and interest should have the basic rate collected at the source, as is now the case with wages and salaries; (*c*) that abuses in family partnerships be checked; (*d*) that certain types of capital gains be more rigidly defined; (*e*) that while preserving the present depletion allowance on oil and gas for small operators who are not able to distribute drilling risks within their own enterprise, that an equal allowance is not needed in the case of large operators who can distribute risk through numerous drillings;[7] (*f*) that there should also be a tightening of the estate tax in reducing the amount by which the tax can be avoided by gifts in anticipation of death by trusteeship, etc.

9. The extra revenue obtained by plugging or reducing these loopholes should, in my judgment, be devoted to three sets of purposes:[8]

(*a*) Reducing or eliminating certain excises such as those on communications, transportation of persons and property, admissions, and most of those except liquor, tobacco, and gasoline excises.

(*b*) Making some reduction in the income tax paid by those in the lower brackets. In this connection I would like to suggest that the first $1,000 of taxable income be taxed at the rate of 15 percent rather than 20 percent as at present. The present 20-percent rate would then be applied to the second $1,000 of income. For those with taxable income at the top of the first bracket or above, this would give a maximum tax reduction of $50 for the single person and $100 for a married man.[9]

(*c*) As we plug the loopholes in the tax structure, we can also somewhat reduce the scheduled rates in the upper brackets of Federal income and inheritance taxes. This would produce greater fairness

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[6] In this period the cash budget showed a net surplus of $22 billion and showed a deficit only in the Korean war year of 1950. The administrative budget was in balance in 3 of the 6 years and showed a net surplus of $3.8 billion in the same period. Both the cash and administrative budgets have shown deficits in the fiscal years 1953, 1954, and 1955.

[7] For a specific recommendation see my amendment and remarks in the Congressional Record for June 30, 1954, pp. 8861–8865.

[8] Depending on the nature of the provisions and whether or not they were backdated to the first of the calendar year, approximately $2.5 to $2.75 billion could be recaptured. If in addition, or in lieu of these, the split-income provision were removed, it, of itself, would provide revenues in the magnitude of $3 to $3.5 billion.

[9] The revenue losses involved are in the magnitude of $2.5 to $3 billion.

as between individuals in the same income bracket. I must repeat, however, that we should not make the Federal tax system less progressive. On the contrary, I believe we should make it somewhat more so. The American public properly believes in taxation according to the relative ability of individuals and families to pay. While a detailed discussion of this issue would involve elaborate treatment which present space does not permit, the sense of justice of the people favors a progressive tax structure. This should be carried out in practice. But even without any such marked change, a real improvement can be effected. In my judgment, we should not delay action.

PAUL H. DOUGLAS.

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84TH CONGRESS
2d Session

SENATE

REPORT
No. 1311

A PROGRAM FOR THE LOW-INCOME POPULATION AT SUBSTANDARD LEVELS OF LIVING

REPORT

OF THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

TO THE

CONGRESS OF THE UNITED STATES

JANUARY 5, 1956.—Ordered to be printed

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JOINT COMMITTEE ON THE ECONOMIC REPORT

(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

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84TH CONGRESS } SENATE { REPORT
2d Session } { No. 1311

A PROGRAM FOR THE LOW-INCOME POPULATION AT SUBSTANDARD LEVELS OF LIVING

JANUARY 5, 1956.—Ordered to be printed

Mr. DOUGLAS, from the Joint Committee on the Economic Report, submitted the following

REPORT

[Pursuant to sec. 5 (a) of Public Law 304 (79th Cong.)]

The following report of the Joint Committee on the Economic Report was prepared by the Subcommittee on Low-Income Families, composed of Senator John Sparkman, chairman, Representative Augustine B. Kelley, and Senator Ralph E. Flanders. The report from the subcommittee was approved for transmission to the Congress by the full committee on December 28, 1955, and will be given further consideration by the committee in connection with its report on the 1956 Economic Report of the President. The findings and recommendations presented in this report are based upon hearings and studies conducted by the subcommittee during 1955. We are grateful to the Bureau of Labor Statistics, Department of Labor, for lending us the services of Miss Eleanor M. Snyder, who served efficiently as staff economist for the subcommittee during the past year.

INTRODUCTION

During the past decade, American families have achieved impressive gains in their level of income and economic well-being. Our staff report, Characteristics of the Low-Income Population and Related Federal Programs, shows that, measured in constant (1948) dollars, 3 out of every 10 families had money incomes of $5,000 or more in 1954, compared to about 2 out of 10 families in 1948. Nevertheless, it is clearly evident that despite the stability of the economy and our continued economic growth, a significant portion of the population has not shared in the overall advance in economic well-being. Of every 10 families in the United States, 1 family still receives a real money income of less than $1,000, and slightly more than 2 families have a

real income of less than $2,000. There has been little change between 1948 and 1954 in the number of lower-income families: there were 9.4 million families with incomes under $2,000 in 1954, compared to 9.6 million in 1948, measured in terms of the 1948 price level.

These figures, of course, do not indicate how many of these low-income families are living at substandard levels. Many possess other economic resources—savings and investments, subsistence farms or other nonmoney income, owned home, etc.—and hence maintain an adequate level of living despite a limited cash income. Such families are not members of the substandard group with whom we are concerned. There are, in addition, other families with low current incomes who have suffered merely a temporary income loss, and thus their problems are short-run in character. There are no precise estimates of the proportion of our total population with substandard economic status—i. e., those whose total economic resources over long periods of time are not sufficient to provide an adequate level of living. The materials assembled by our staff, however, indicate that the size of this population at permanently depressed levels of living is substantial; one study made available to us, for example, puts the proportion as high as 20 percent of all urban families and individuals. Such families primarily consist of the aged, widows, broken families, and the disabled. Additional studies, however, are needed to determine more precisely the characteristics of the families and individuals with substandard economic status.

It may always be true that at any given time the economic resources of some families may temporarily fall below a level of adequacy. We have, as a nation, made considerable progress in lessening the hardships caused by temporary income loss through the expansion and continued application of sound insurance principles. Moreover, positive and constructive Federal programs directed toward maintaining a stable economy and full employment have reduced, in large measure, the number of families with temporary income losses due to lack of employment opportunities.

We are especially concerned, however, with the fact that millions of American families are today living at income levels permanently, not temporarily, depressed and which are below prevailing standards of adequacy. The low economic status of these families signifies that they are participating only fractionally in our economic life. They contribute little to our national productive effort; as consumers they are severely limited in the amount of goods and services they can buy.

The continuing prevalence of families and individuals with low economic status represents, in short, one of the greatest remaining challenges facing our domestic economy. We are convinced that with national income at peak levels and with relatively full employment, now is the time for a renewed and vigorous attack on the remaining problems of low-income groups.

The Federal Government must assume a positive role, but we do not believe that responsibility for further constructive action lies with the Federal Government alone. To meet the problems effectively will require the concerted efforts of all segments of our national life—all levels of government working with labor and management and private community groups and organizations. With such coordinated, positive action, we are confident that, in overall terms, the total cost will

be low when measured by the positive economic gains which will be generated throughout the total economy, and also when measured by the resultant strengthening of the forces which produce an alert, productive, and democratic society.

It has been illustrated, we wish to emphasize, that many programs aiding the low-income group actually are economic investments which yield a positive economic return, through such avenues as increased tax payments of those whose earning power and productive capacity have been expanded or through reduction in the type of financial aid which merely maintains the individual or the family without providing the services and the training required to help them become more productive members of society. Perhaps the most important investments of all are those expenditures which enable children now in economically disadvantaged families to rise above their current economic level and, as they reach working age, to enter the labor market better equipped in terms of health, education, and training than were their parents.

We recognize, of course, that not all of the individuals whose current economic status is low can become more productive. The very aged and the totally and permanently disabled—the technically unemployable groups—are important components of the low-income population. In our study of the causes of permanently low income and of the means of alleviating them, we have, therefore, deemed it advisable to define the following groups whose economic status is below the level of adequacy:

(1) Individuals or family units with no members whose productive capacity could be raised significantly; and

(2) Individuals or families with members who can be aided in their efforts to increase their earning power.

We recognize that those belonging to the first classification can be assisted in improving their capacity for self-care and thereby perhaps release others for more productive labor. As individuals, the primary needs of these incapacitated groups are more adequate financial support and increased health-care services, although there may be much more complex needs and problems facing other members of their families.

While not neglecting or ignoring the first-mentioned group of those who are unemployable and who will continue as dependent members of society, this subcommittee chose to focus its primary attention this year on ways and means whereby other members of the low-income group can be assisted in their efforts to improve their earning power and levels of living.

Basic materials on the size and characteristics of the low-income population were assembled and published as a joint committee print entitled "Characteristics of the Low-Income Population and Related Federal Programs, Selected Materials Assembled by the Staff of the Subcommittee on Low-Income Families." This document was distributed to members of the joint committee, potential subcommittee witnesses, and other interested persons on October 30, 1955. We believe the data presented in that report are a valuable summarization of materials on the problems of low-income families.

The subcommittee held 8 half-day sessions of open hearings in Washington during the period November 18–23, 1955. Testimony was received from Government officials, educators, economists, and

other qualified witnesses on the following topics which served as the focus of this year's subcommittee's study:

(1) The role of the Federal Government in programs to aid the low-income population;

(2) The function and economic value of income-security measures, public assistance, vocational rehabilitation, and health programs;

(3) The role of education and training programs in improving the earning capacity of the individual, and in breaking the cycle of self-perpetuation within the low-income group; and

(4) Measures designed to reduce the number of rural and industrial areas which are characterized by chronic labor surplus and underemployment.

We would like to note at this point that our current study, together with our findings and recommendations, draws and expands upon the work done by the earlier Subcommittee on Low-Income Families established by the Joint Committee on the Economic Report in 1949 during the 1st session of the 81st Congress. The work of both of these subcommittees has been carried out under the Employment Act of 1946 which sets forth the responsibility of the Federal Government to utilize its programs and resources in a manner calculated to promote maximum employment, production, and purchasing power, and to foster free competitive enterprise and the general welfare. These are goals which emphasize the need for continuing economic growth and a steady expansion of the Nation's capacity to produce and consume.

Findings and Recommendations

The problems of low income, although numerous and complex, are not insurmountable. We have the wealth, the human and material resources, the skills, and the free institutions to solve them. We can solve them if we possess the will and the desire to put forth the necessary effort. We have, moreover, as we have stressed, economic as well as humanitarian incentives to solve these problems as rapidly as possible.

The complexity of the problems of low income inevitably requires a many-faceted approach to their solution and the coordinated efforts of all Government and private groups directed toward helping members of the low-income groups help themselves. This subcommittee, however, functioning under the directives set forth in the Employment Act of 1946, is concerned primarily with programs which involve Federal participation.

During the course of our investigation, we have received a great many proposals for recommended action. We want to make it clear that the recommendations we present are directed toward those problems which, as a result of our findings, we feel the need for immediate action is most urgent. Further, we wish to make it clear that in forming our proposals we considered them in the framework of the broad objectives of the Employment Act of 1946. Our report does not present estimates of the costs or priority of our various recommendations in relation to other needed expenditures, nor have we explored the questions of administration which may be entailed.

We want also to reemphasize that it has not been possible or desirable in the limited time available to us to investigate all types of proposals which impinge directly or indirectly upon the low-income population. We recognize that there are many important topics—such as housing, for example—which were not included in our program of study. It should not be inferred from their omission from this report that we consider them unimportant or insignificant.

I. INCOME SECURITY, PUBLIC WELFARE, AND HEALTH CARE

Throughout our investigations it was repeatedly emphasized that, as a basic principle, our programs and policies should emphasize prevention of need rather than merely providing relief after need has arisen. We agree with this principle.

We have made substantial progress in our Nation in providing income security and protection against income loss through comprehensive insurance programs. There is a continuing need, however, for legislative review of the adequacy of benefits provided by the existing social-insurance programs. Ways and means should be developed for improving the adequacy of benefits. We feel the same type of review is necessary for programs which provide assistance on the basis of need. Moreover, we should continue to move forward in the improvement and expansion of the insurance plans now established and eliminate the current limitations in coverage as rapidly as possible.

Despite the progress already achieved, there still exist significant gaps in our social-insurance programs. Some causes of income loss which present insurable risks are not covered on a national basis. Nevertheless, the Federal Government itself already has demonstrated some are insurable risks through programs it has established for specified types of workers.

An outstanding gap in social insurance coverage is income loss due to ill health, however caused. We believe that the Federal Government possesses direct responsibility for expanding social-insurance and other programs to provide protection against the contingencies of temporary disability and permanent total disability. Such provisions should mesh, not conflict with State programs already established.[1]

We recommend—

(1) The Congress consider legislation to establish social-insurance programs covering the risks of temporary and permanent total disability.[2]

(2) The appropriate congressional committees study the desirability and feasibility of dovetailing such programs, if established, with the workmen's compensation acts of the various States; such study will necessarily entail a review and evaluation of the adequacy of the existing workmen's compensation programs.

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[1] Workmen's compensation acts of the States provide for cash payments to some workers for work-incurred disability. In addition, four of the States have established insurance plans for temporary illness or disablement not arising out of the covered worker's employment.

[2] Senator Ralph E. Flanders. This undertaking must be approached with great caution. Many insurance companies have had to discontinue disability benefits owing to the difficulty in defining "disability," whether temporary or permanent, in any given case.

Adequate health care—medical and dental services and hospitalization—is not received by many low-income families for one of two reasons, or for a combination of these reasons: (1) inability to pay, and, (2) particularly in isolated rural areas, unavailability or inaccessibility of adequate facilities. In addition to those with the lowest family income status, many other families who provide for their normal day-by-day needs are unable to pay for adequate health care out of their own resources. We believe that the ultimate cost of inadequate health care to the Nation, in terms of lessened productivity as well as income loss, can be substantially reduced by measures designed to increase preventive and curative health care received by the medically needy.

We recommend—

(3) That the Federal Government, in cooperation with the States and private groups, develop a comprehensive health program covering the following:

(*a*) Stimulation of means whereby families in rural areas may secure adequate health care;

(*b*) Provision of additional funds to provide for adequate recruiting and training of professional workers in the field of health care;

(*c*) Reduction in the cost to the individual of comprehensive health protection. This may necessitate contributing part or all of the cost of approved insurance programs for low-income families. The Congress may wish to consider whether it may be necessary, in order that voluntary health plans reach all of the population, to provide Federal financial aid to those in the low-income groups who are unable to purchase such protection; additional funds alone, however, would be useless to millions of our people in rural areas where there is a lack of doctors, nurses, and hospital beds;

(*d*) Extension of the school-lunch and milk programs, and the distribution of surplus commodities to needy families; and

(*e*) Expansion of Federal participation in public-assistance payments for medical care.

We believe that with some additional changes in the federally aided public-assistance programs, current inequities will be eliminated and the way opened to aid a larger proportion of families with low economic status. Aid rendered through the public-assistance programs—including nonfinancial services as well as direct income supplements—can and should serve 2 functions: (1) to provide subsistence to needy families and individuals; and (2), by means of the nonfinancial services in particular, to assist families in their efforts to improve their productive capacity and earning power.

We recommend—

(4) That the following changes be considered in the Federal grant-in-aid program of public assistance:

(*a*) Establishing a single, unified system of Federal grants for general public assistance in place of the current and separate programs which, according to evidence presented to the subcommittee, tend to restrict unnecessarily the types of need for which Federal funds are available;

(*b*) Basing Federal grants-in-aid for general public assistance on an equalization formula which takes into account the relative financial needs of the various States and State differences in per capita income;

(*c*) Lowering the maximum residence requirements which the States can impose on public-assistance applicants; and

(*d*) Making the Federal grants for child-welfare services available to all areas rather than limited as they now are to specially designated areas.

Many witnesses appearing before the subcommittee emphasized the value of nonfinancial assistance extended by public welfare and other services to the low-income population. Such assistance strengthens the family unit, provides a unified, comprehensive approach to the various problems which a particular family encounters, and can be of major value in helping the family improve its economic status and productive capacity.

We recommend—

(5) Including in the Federally aided public-assistance programs provision for services designed to encourage individuals to attain self-support and self-care and to preserve and strengthen family life.

(6) That the Federal Government consider providing additional grants-in-aid to the States for the purpose of increasing the supply of trained professional workers needed to carry out the recommendations we present in this report.

II. INCREASING EDUCATIONAL AND TRAINING OPPORTUNITIES FOR THE LOW-INCOME POPULATION

For over a century, in a variety of ways the Federal Government has provided aid to education in cooperation with the States and educational institutions. More recently, during and after World War II, it has enabled millions of service men and women to raise their level of formal education while they were in the armed services and, under the GI bill of rights, after their return to civilian life. As these programs taper off, there will be a corresponding increase in the burden already straining the financial capacity of some State and local governments, unless the Federal Government in other ways continues to share in the cost of providing adequate education and training.

From the materials assembled by the committee staff and the statements and testimony of the experts who appeared before the subcommittee, it is clearly evident that as a nation our investment in our greatest actual and potential resource—our children—is inadequate. We are, in a very real sense, limiting our future economic growth by the extent to which we do not promote the maximum realization of the productive potentialities of the younger generation.

We have received many suggestions as to how the Federal Government, in continuing its long-established participation in education, now may best assist in providing adequate educational opportunities to all of our population and in overcoming the current shortages and inadequacies of our public schools. The role of the Federal Government, first and foremost, we believe, is to stimulate and encourage local

and State efforts to improve educational opportunities. Continuation or expansion of Federal aid, of course, does not require Federal control over our educational systems. We are firmly convinced that such control is best exercised at the local and State levels and should and must remain at these levels.

A substantial number of persons—adults as well as children—are not receiving enough education, or enough of a suitable kind of education, to permit them to avoid self-perpetuation in the low-income group. School plant and equipment fall far short of total needs; the current rate of construction, while at an all-time high, is not great enough to eradicate within a reasonable length of time the shortage resulting from the backlog of accumulated needs and the needs arising from expanding enrollments. Inadequate teaching staffs and, in some communities, poor quality teaching, combine to prohibit full realization of the productive potentialities of our children and of those who have already commenced their working life. In other instances, the kind of training being received is not that best suited to the individual himself in terms of his capacities, nor does it provide adequate background for his future occupational needs. Many witnesses at the subcommittee's hearings emphasized that, in the long run, raising the educational level of members of the population with low economic status is a significant factor in preventing the self-perpetuation of this group.

There is much to be accomplished immediately if we are to provide an adequate, basic education to those of our children who are now of school age and to insure that succeeding generations of children will be afforded improved opportunities. In our recommendations which follow, we have stressed the types of positive programs which, in our opinion, will best meet the most urgent and pressing needs, as well as laying a firm foundation for provisions against the needs of future generations.

We recommend:

(1) Direct Federal grants-in-aid to the States, initially for construction of school plant and equipment, based on an equalization formula which takes account of the relative economic need among the States.

In considering the particular problems of children of low-income families, we recognize that in many cases such children are not motivated at home to take advantage of the educational opportunities which already exist, nor are they taught at home to appreciate fully the close connection between future earnings and educational attainments. The school system can help increase awareness on the part of these children of the values of education, and strengthen their motivation to remain in school at least through the high-school level.

We recommend:

(2) That the Federal Government, through grant-in-aid programs, assist the States to expand guidance services and vocational counseling provided within the school systems.

A significant proportion of children from low-income families drops out before completing their high-school education. In some cases the children feel compelled, for economic reasons, to leave school and ob-

tain a job to help support the family; in other instances, they lack the financial resources required to pay for additional schooling.

It is also true now perhaps as never before, that education can and should be a continuing experience which does not end upon completion of a specified number of years of formal schooling. Our expanding and changing technology, the expanding application of automation, and the gradual shifts in the relative demand for particular types of skills all require a flexible, highly trained labor force. There is increasing need, therefore, to permit adults who so far have not achieved a minimum education to "catch up" through voluntary participation in educational programs. In addition, provision should be made for the acquisition of new skills in order that we may meet the needs of the expanding economy.

We recommend:

(3) The establishment of a national scholarship fund to aid those who could profit from additional education but who lack the necessary financial resources.

(4) Expansion of adult education programs through Federal financial assistance extended to such institutions as the recognized and accredited colleges and universities; and, encouragement of vocational training and retraining programs sponsored by nongovernmental groups in our economy.

III. AID TO ECONOMICALLY DEPRESSED RURAL AND INDUSTRIAL AREAS

It is evident that despite the generally prevailing high levels of employment and productivity and the steady economic growth which our country enjoys, some geographic areas have not shared in the overall advance. Some areas, especially rural areas, throughout their entire existence have never kept up with the rate of growth of the country as a whole; others have experienced a decline—slow or precipitous as the case may be—until the resulting economic stagnation has produced serious problems of continuing unemployment and underemployment of all local resources.

The existence of areas of low economic activity seriously retards the rate of national growth, and is in itself a significant cause of self-perpetuation of low-income, underemployed groups. The goal of achieving full utilization of our national resources—land, labor, and capital—will never be attained as long as these geographic pockets of continuing economic depression persist. Ours is a dynamic, expanding economy; the very process of growth itself, along with the attendant changes and improvements in technology, now produces and inevitably will continue to produce some dislocation and imbalance of local resources. Without preventive planning and action, it appears inevitable that such temporary dislocation may well cause additional areas of chronic depression to develop. We feel most strongly that solution of the depressed-area problem is many-faceted and requires concerted action by all levels of government in cooperation with labor and management, church groups, and community organizations.

Measures to help those with low economic status, such as described in our recommendations presented in sections I and II of this report, will, of course, alleviate some of the problems of low income in depressed areas. Our preceding recommendations, however, are directed toward alleviation and prevention of low income arising from

causes associated with the individual; they are not directly related to causes of low income associated with the economy. Other types of measures to reduce chronic unemployment and underemployment in particular geographic areas are needed.

We believe that, in general terms, programs designed to aid depressed areas—those characterized by underemployment and misallocation of resources—have much in common, regardless of whether they relate to agricultural or industrial areas. Both types of areas (or, on a smaller scale, communities) require additional capital resources, new industrial development to absorb labor surpluses, increased availability of credit and technical assistance to the community and to the small farmer or businessman; expansion of educational and training opportunities available to the local population; enlarged and improved community facilities and services; greater access to adequate health care, and so on. Since, however, there are some differences in emphasis we place on the types of Federal assistance on which we urge immediate action, our specific recommendations relating to depressed agricultural and industrial areas are listed separately.

A. Depressed agricultural areas and aid to low-income rural families

We want to stress that while recognizing one of the most urgent needs of low-income farmers is increased access to credit, extension of credit to those who are considered "poor risks" by commercial credit agencies probably is foredoomed to failure unless accompanied by a greatly expanded program of technical aid to the credit recipient. Greater emphasis must be placed on intensive technical assistance to such families so that they may develop a coordinated family farm program best suited to their personal resources and to the land which they farm. Credit improperly applied or administered would tend merely to reinforce the tendency to remain on the land without utilizing the additional capital received to improve methods and efficiency of operation.

Over the years the Farmers' Home Administration has helped many low-income farmers improve their economic status by providing intensified technical assistance in conjunction with the loans it has made, and in our opinion, this agency is best equipped to provide the technical assistance we are recommending.

We believe that the most effective type of technical assistance consists of two parts: (1) The development of a family farm plan for individual families which, if carried out, will provide an adequate level of family living; (2) the encouragement and guidance of the farmer toward the plan's fulfillment by means of frequent personal visits of the technical agent to the individual farm.

We recommend:

(1) Expansion of the credit programs now available to farmers, with increased emphasis on loans extended to low-income farmers.

(2) In combination with expansion of credit programs for low-income farmers, a corresponding increase in the provision of technical assistance to the individual farm families receiving loans, such assistance to include development of an appropriate farm plan for the individual family and extending the technical guidance and leadership required to help the family carry out the plan proposed.

We also believe that economic incentives of many low-income, rural families could be aided, their family life strengthened, and their material well-being improved if they had greater access to the type of aid extended by the Federal-State extension services.

We recommend:

(3) Consideration be given to the development of farm extension services to meet the needs of low-income farm families in particular, and to greater utilization of trained workers to assist the family improve all aspects of its family life. As a first step toward a better life, it should be possible to help the family get improved subsistence from the land on which they are now living.

It is apparent that a threefold approach is required to meet other aspects of the problem of chronic labor underemployment in low-income farm areas: (1) Encouragement of off-farm employment by development of new industrial location within the area; (2) assistance of farm families willing to migrate to other areas and who possess definite job opportunities in the new location; (3) provision for greater opportunity for rural people to obtain training for nonfarm occupations.

We recommend:

(4) Consideration of the following program designed to meet these particular needs:

(*a*) By means of technical assistance and Federal loan guaranties, aid recognized and approved local groups engaged in attracting new industry into the area, and develop other ways of providing off-farm employment. These programs (which also are recommended for extension to depressed industrial areas) should provide maximum stimulus to private investment in areas now depressed but which possess advantages of location or resources that, in combination with such investment, make economic growth practical and feasible;

(*b*) Assist in the development of a program for financing approved cases of out-migration of individual families;

(*c*) Expand vocational counseling and job placement services in depressed agricultural areas; and

(*d*) Expand in rural areas the federally aided nonfarm vocational training programs.

B. Depressed industrial areas and aid to low-income families

It was emphasized during our hearings that expansion of economic activity provides the only long-run solution to the problems of industrial areas with a chronic labor surplus. To achieve this goal, local producers should be enabled to take advantage of additional opportunity to expand and increase their level of output; surveys are needed to appraise and evaluate existing and potential local resources, in order to assess the area's capacity for future economic growth; new industries and expanding industries which can put local resources to economic use must be encouraged to establish plants in depressed areas; ways and means should be provided to assist low-income families who wish to migrate to other areas where there is a labor shortage; and, assistance must be given to needy workers willing to undergo retraining in basic skills for which there is adequate demand.

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As we said earlier, problems of such magnitudes cannot be solved through Federal effort alone. In the long run, there must be determined and lasting cooperation between all strata of our economic life, and most important, the depressed areas and communities must themselves provide the will and the sustained interest in improving their economic status. Remedies superimposed from without seldom effect lasting cures. Our evaluation of the role of the Federal Government in aiding depressed industrial areas in particular is described by the specific recommendations which follow. As we have stated, it is for the most part similar to our evaluation relating to depressed rural areas.

We recommend:

(1) Substantial expansion of existing programs of technical assistance to depressed industrial areas and to small producers within the area.

(2) Credit aids be extended, when such assistance is economically desirable to existing local industries, and to approved local groups engaged in planning and constructing "ever-available" plants for the purpose of attracting diversified and expanding industries. Credit aid may possibly take the form of loan guaranties designed to promote maximum stimulus to private investment.

(3) That the Federal Government share in planning and conducting appropriate economic surveys to determine the scope of current and potential local resources.

(4) Expansion of the small-business program, with particular emphasis on aid to depressed areas, and coordinated with a strengthened program of decentralization of defense contracts.

(5) Extension of vocational counseling, job information, and placement services of the Federal-State employment services so that workers in depressed areas will be aware of job opportunities in other communities. In addition, these agencies should expand their function of alerting employers outside of depressed areas, as well as within, to the types of skills currently available in depressed areas.

(6) That financial assistance should be provided to unemployed workers willing to undertake the approved retraining programs, and to those willing to migrate to areas of labor shortage.

IV. FINDINGS AND RECOMMENDATIONS IN REGARD TO ADMINISTRATIVE AND RESEARCH NEEDS

A. Depressed rural and industrial areas

It was emphasized in the subcommittee's hearings that the Federal Government should focus primarily on the long-range objectives set forth in the Employment Act of 1946, while recognizing that appropriate short-run measures can assist in meeting these goals. In order to continue to provide the economic climate vital to economic expansion, it is essential that in its concern to alleviate distress in areas currently depressed, the Federal Government neither advocates nor embarks on measures which are merely palliative and are not curative in their total effect. We must recognize the dangers inherent in the type of emergency program which merely attempts to deal with "spot"

problems of economically disadvantaged areas. Moreover, measures designed to habilitate or rehabilitate particular areas should not, as a byproduct, foster the creation of new depressed areas elsewhere. Therefore, all remedial measures undertaken by the Federal Government must be cast within the framework of the economy as a whole.

In conducting our study, we realize that separate recommendations are not sufficient. There must be at the Federal level development of a comprehensive, unified program which attacks the many problems of continuing low income in depressed areas in a consistent and concerted fashion.

We recommend:

(1) That there be established in the executive branch of the Federal Government a central group charged with the responsibility of preparing a coordinated, comprehensive program aiding currently depressed industrial and rural areas and so designed as not to affect adversely other areas. Such a program must assist in maintaining the economic climate necessary to promote maximum economic growth of the economy as a whole.

The subcommittee's investigations reveal that there is a pressing need for extended research to provide the economic facts and analyses required in order (1) to help currently depressed areas achieve a higher level of economic activity, and (2) to prevent the creation of additional areas of chronic labor surplus.

We recommend:

(2) Increased research along the following lines:

(*a*) A continuing program of study is needed to analyze regional and technological shifts so that trouble spots can be detected early enough to make for practical preventive action, such as encouragement of new enterprises in an expanding industry in areas where a major enterprise in a declining industry is expected to close down;

(*b*) An inventory of labor skills and economic assets should be compiled for each area now marked by concentrations of low incomes and chronic unemployment, to make it possible for public and private groups to match the available local resources with the needs of expanding industries so that new enterprises could be attracted to these depressed areas;

(*c*) For each distressed area, improved and more detailed reports on unemployment, labor force, percent unemployed, and number of new jobs to be created;

(*d*) Regular reporting of work stoppages by areas with some suitable measure of its relative importance in each area; and

(*e*) More information on differences in costs of living and in wage rates between areas and communities.

B. Low income resulting from causes associated with the individual

During the course of the subcommittee's hearings it was repeatedly emphasized that the population at permanently depressed income levels consists of two groups: (1) Those who for one reason or another cannot be expected to become more productive, and (2) individuals or families with members who possess the potential capacity to increase their productive power and thereby their level of earnings. The types of positive remedial action by Government and other groups vary in accordance with the particular needs of each group. We believe that the level of dependency will decrease, as provisions against income loss are expanded, preventive and curative health care services and health information are made increasingly available to low-income groups, and the productive capacity of the families and individuals are increased by means of greater educational and training opportunities, application of vocational rehabilitation measures, and so on. In the long run, therefore, emphasis should be placed on prevention of poverty rather than on alleviating poverty after it once develops. In order to assess the need for specific current and future programs it is necessary to know more precisely the size and particular characteristics of the population with continuing low economic status.

We recommend:

(1) Intensive studies to identify the population at substandard levels of living and the causes of their low economic status.

We believe that as the proportion of the population in the middle- and older-age groups increases, new problems of low income may arise if not planned for in advance. Already displaced middle-aged and older workers are encountering difficulties in obtaining new employment; unless the productive capacity of this group is fully utilized, the economic growth of the Nation is limited unnecessarily.

We recommend:

(2) That the Federal-State employment services place greater emphasis on job-placement services for the older worker.

(3) That, in all ways possible, government—Federal, State, and local—encourage industry to employ older workers willing and able to work and to make more jobs available to this group by redesigning work to fit their capacity.

The Federal Government, through a multitude of programs, is tackling the remaining problems of low income in many ways; we have recommended some changes and redirection of Federal efforts. Looking toward the future, we feel that the Congress should continue its study of low-income problems and evaluate, from time to time, the measures taken by the Federal Government to solve them.

We recommend:

(4) That the appropriate departments and agencies of the executive branch prepare a report on the current status and size of the low-income population and the progress made in the alleviation of poverty and elimination of its causes, such report to be submitted to the Joint Economic Committee during the 85th Congress, and periodically thereafter.

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84TH CONGRESS
2d Session

SENATE

REPORT
No. 1312

FOREIGN ECONOMIC POLICY

REPORT

OF THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

TO THE

CONGRESS OF THE UNITED STATES

JANUARY 5, 1956.—Ordered to be printed

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Mr. DOUGLAS, from the Joint Committee on the Economic Report, submitted the following

REPORT

[Pursuant to sec. 5 (a) of Public Law 304 (79th Cong.)]

The following report of the Joint Committee on the Economic Report was prepared by the Subcommittee on Foreign Economic Policy, composed of Representative Richard Bolling, chairman; Senators Paul H. Douglas, J. William Fulbright, and Ralph E. Flanders, and Representative Henry O. Talle. The report from the subcommittee was approved for transmission to the Congress by the full committee on December 30, 1955, and will be given further consideration by the committee in connection with its report on the 1956 Economic Report of the President. The findings and recommendations presented in this report are based upon the subcommittee's recent hearings and study of foreign economic policy. We are grateful to the Legislative Reference Service, the Library of Congress, for lending us the services of Dr. Charles S. Sheldon II, who served efficiently as staff economist to the subcommittee during the past year.

INTRODUCTION

On March 14, 1955, the report of the Joint Committee on the Economic Report stated (pp. 4 and 5):

> By terms of the Employment Act, the Joint Committee is charged not only with reporting on the main recommendations of the Economic Report, but is directed also to make a "continuing study" of economic matters. Subcommittees will accordingly be set up to study several areas which seem especially worthy of early investigation.
>
> *Subcommittee on Foreign Economic Policy*
>
> The committee's recent hearings revealed the need for an investigation of the significance of the whole complex of our international economic relations for the stable growth of the Nation's domestic economy. The Subcommittee on Foreign Economic Policy will undertake an appraisal of the basic theories of

foreign trade as they pertain to the position of the United States in the world economy. It will attempt to determine the nature and the source of the comparative advantages enjoyed by the major participants in international markets and the impact of their trade policies not only on the overall trading position of the United States but also on the condition of our major industries. For example, the subcommittee will attempt to develop a clear picture of the extent to which relative wage rates and other elements of industrial cost structures affect our competitive position relative to that of our more important trading partners, as well as the extent to which these cost differentials give rise to trade policies such as dumping, import quotas, exchange controls, etc.

This appraisal of foreign-trade theory will provide the basis for considering the feasibility of setting up broad criteria to be used in developing an effective international economic policy and in evaluating specific proposals in the field of foreign trade. It will assist in understanding the stresses imposed on our domestic industries by changes in the international economy and the character of the adjustments these industries may be required to make. In addition it will help us to appraise the strengths and weaknesses of our foreign trade policy as an instrument in the cold war.

In the course of this study, the subcommittee will need to review the adequacy of the present statistics dealing with international economic activity. Its recommendations in this respect will be incorporated in the work of the Subcommittee on Economic Statistics.

The major work of the subcommittee has been the holding of public hearings which considered a broad range of problems within the scope of the subcommittee directive. The subcommittee during the course of 12 sessions heard from 40 witnesses drawn from academic, business, labor, farm, financial, government, and research backgrounds. Although they were drawn from many organizations, each witness was invited primarily for his professional knowledge and experience, and was asked to assess a part of the problems under review from an impartial and national point of view. Inevitably such broad representation brought contrasts of opinion, but it is still possible to recognize general areas of agreement, and these have been taken into account in the preparation of this report.

It is worth noting that the activities of the subcommittee were designed not to duplicate the work of any of the standing committees of the Congress. There was no attempt to frame specific legislative recommendations, nor to hear an unlimited number of witnesses, each reporting on whatever interests seemed appropriate to him. Rather, each witness was asked in the light of his knowledge to prepare a section of the larger and coordinated study undertaken by the subcommittee.

It is equally clear that it was not possible in the limited time available to the subcommittee to investigate all aspects of foreign economic policy, nor to engage in detailed industry studies. The subcommittee is particularly mindful that it did not give more than cursory treatment to the problems of international investment, technical assistance, and foreign aid. Nor did it examine the economic consequences of present and alternative shipping policies.

Nonetheless, a general frame of reference has been established and future studies well can use this work as a point of departure for more detailed and specific applications. It is all too easy in studying limited and specific problems in the detail required to run the risk of losing sight of the general national interest, the repercussions which follow from any immediate policy, and the alternative benefits which may have to be surrendered to achieve the specific goal sought. The type of framework constructed in this investigation should help to maintain proper proportionality in related specific studies.

During the period of time that the subcommittee has conducted its studies there have been several apparent shifts of Sino-Soviet policy, although there is no evidence of any basic change of Communist objectives in the long run. These outward signs have a bearing on the emphasis of parts of this report, but not upon its overall conclusions. Early in the calendar year the threat in the Formosa Strait seemed to have brought us very close to war. Then the emphasis swung to sweetness and light at Geneva in the meeting at the summit. It was made clear at that time that the area of struggle was more likely than not to be economic, which gave a special importance to our review of trade policy. The second meeting at Geneva and the rapid succession of events since that time have shown Soviet intentions in a truer light, and have shown that in fact there is a dual and integrated campaign being waged by the Communists for conquest of the world. They still stand ready for military adventures, particularly if they can induce others to carry the brunt of the fighting. They are also waging an aggressive, coordinated economic-political-psychological attack on the unity of the free world. Their goal is to bring neutralist states into their orbit, as the satellites have gone already, and to weaken the alliances of the nations already committed in the struggle for freedom.

The effect of these developments on foreign economic policy is to throw in sharper relief the necessity for moves to aid the cooperation of the countries of the free world to assure their military and economic strength. It also makes more urgent a reexamination of the economic advantages and disadvantages of alternate trade policies, both for their repercussions on the growth and stability of the domestic economy and also for the contribution which these policies can make toward our broad goals of foreign policy.

Our findings and recommendations for improving trade freedom and expanding commerce relate primarily to the countries of the free world. They are recommendations which would be important in a world truly at peace because these policies would contribute to the well-being and prosperity of the United States. They are equally or more important in a world faced by the threat of Communist aggression—military, economic, and subversive—because these policies will not only redound to our benefit but strengthen our allies whose survival as free countries is so essential to our own liberty and safety. Our references, then, to worldwide trade refer to trade among those states which are essentially interested in living in harmony and mutual respect, rather than to the whole geographic world. We also present some specific findings with regard to trade with the Sino-Soviet bloc which have an appropriate place in this record.

There follow the principal findings based upon the hearings referred to above, together with summary recommendations to the full committee.

Findings

I. General Importance of Trade

(*a*) *Foreign economic policy is a part of foreign policy in general and its implementation should contribute to our total national goals, economic, social, political, and military.* The shrinkage of the world through improved communications, the totalitarian efforts to spur

ideological conflict, and the growing need for new supplies of raw materials and enlarged markets make trade more vital than ever before. Our foreign economic policy is broadly conceived to include not only specific Government measures in such fields as tariffs and foreign economic aid, but also all American economic behavior, public and private, foreign and domestic, which has its repercussions on the rest of the world. Some of our foreign economic policy acts can be planned and coordinated. The rest must be left to the good sense and understanding of private citizens, and this implies necessary thoughtful study by all our people.

(*b*) *The United States is such a dominant economic force in the world that its policies at home as well as in the foreign field have profound effects throughout the world.* With 6 percent of world population, 40 percent of world production, and 20 percent of the trade of the world, almost anything which we do will affect conditions in other countries. Though foreign trade is only 5 percent of our total economic activity, its importance to us extends beyond this mathematical measure because it includes the importation of critical and useful materials, affords profitable margins of sales from our output, and profoundly influences the well-being of the rest of the world with which we must live. Indirectly at least our domestic growth and stability depend upon the peace and prosperity of the whole world. Because the rest of the world is responsive to our behavior, the tariff and similar institutions are no longer purely domestic issues.

(*c*) *Instability in trade policy is one of the most serious threats to the orderly development of trade.* Tariffs, quotas, and exchange restrictions limit trade, but if they are not prohibitively severe, can become factors calculable by the businessman, so that his plans with regard to trade take them into account. But where policies are pursued which show vacillation, inconsistency, and other erratic tendencies, trade in any large volume and at economical cost may become well-nigh impossible. From the point of view of the individual, it would be foolhardy to invest money and time in developing a market which can be snatched away with little warning. From the national point of view, this uncertainty can discourage new investments and make for waste in resource allocation. The penalty is borne by all parts of the economy. Export industries cannot develop foreign outlets. Importers face the threat of extinction. Domestic industries do not know when they will be assailed by foreign competition, or when they will have the local market to themselves.

It would be a tremendous step toward greater progress if the United States and other nations could develop long-run policies toward trade which would be consistent over a period of years, consistent both in application and with their international obligations for strengthening the free world. This consistency would encourage better resource allocation and market development in the interest of greater efficiency and better service. Examples of present inconsistency, some of which will be reviewed presently, include resort to the escape clause, or even the threat of its application, capricious use of the antidumping penalty, application of quotas, and the great variety of administrative controls which can change suddenly or are applied inconsistently to the detriment of efficient trade. The sum total of these inconsistent policies is a war of nerves and of pocketbooks, which discourages enterprise by

increasing the risk of trade to an amount greater than the possible gain. From a national point of view, it strengthens tendencies toward isolationism and self-sufficiency in other countries, which we can ill afford in competition with aggressive Communist strategy.

(*d*) *Where most nations once were united into a world economy, the old order now has been replaced by an international economy of decentralized direction and some tendencies toward autarchy; this puts new emphasis on the necessity for conscious cooperation with other friendly nations.* By and large, the former world economy, based on the gold standard, on British leadership in industrialization, and on other circumstances peculiar to that time, left the forces of inflation and deflation without regulation by individual governments, and such conditions could be imported from abroad. Such a system required that all governments view fiscal and monetary policy in similar fashion, and leave the central direction of credit and prices to the London financial market. The system worked well in its time (before World War I), but probably cannot be restored in its prewar form to work as effectively again.

Today, financial power is more diffuse, although the United States holds a dominant position, and most governments of the world take steps to influence levels of income, employment, and prices within their respective countries. This in turn requires in some situations a regulation of trade and currency exchanges, rather than leaving these matters solely to the automatic forces of the market. Although the newer system does not always work as smoothly as did the old, countries prefer some arrangements to protect them from excessive swings of economic activity in other parts of the world.

Under these circumstances it is more important than ever that countries cooperate if trade peace, stability, and growth are to occur. The institutions of the International Monetary Fund, the International Bank for Reconstruction and Development, and the Organization for Trade Cooperation and similar institutions therefore have a critical role in promoting these objectives and in preventing trade anarchy.

II. INTERNATIONAL COMPARISONS

(*a*) *Adequate statistics for international comparisons and intergovernment use are the key to scientific appraisal of needs for business and government decision making.* The alternative would be to rely on guesswork and half-truths with the inevitable miscalculation of results to be expected in planning tariff policy, exchange rate controls, and foreign investment. A good start has been made to encourage the compilation of a great variety of both simple and quite sophisticated statistics in accordance with agreed-upon uniform standards and definitions.

But this progress should not mislead one to the conclusion that coverage is yet adequate or that standards are being applied with equal rigor in all countries or even that fundamental concepts have been reconciled sufficiently to make valid all types of important comparisons. Many crucial areas of the world do not make basic figures available, notably the Communist bloc countries. What they do reveal is designed to obscure the truth. In the remaining parts of the world significant types of data are not generally available, includ-

ing specifically urgently needed data on national income and product broken down not only by industry and by functional share but also distributed by size of income. This is particularly important to have for the underdeveloped countries. Also needed is cooperation for the world census of 1960.

The United States, although one of the countries best supplied with collected data and trained statisticians, has lagged behind in adaptation of reports to standards of international comparability.

(*b*) *Tariff policy cannot be based on international real cost comparisons and should not even if they could be made.* There is no meaningful way to compare real costs (inputs of labor and materials) from one country to another, for it is prices, not real costs, that influence trade. Nor is the concept of average cost levels for a whole country either measurable or useful. Although trade actually depends upon price comparisons, these are relatively easy to alter through variation in exchange rates, subsidies, and the normal disparity which may exist at any one time between prices and long-run money costs. Although the price of a commodity entering international trade can be and is translated through an exchange rate, it is fallacious to compare internal money costs in different countries through the use of exchange rates. For example, the components of living costs in different countries vary not only in relative prices but in proportional importance to local living standards.

(*c*) *The test of acceptability of foreign imports cannot be in terms of the absolute technical efficiency of their production, even if it could be measured.* The market mechanism for allocating resources, which is the basis of a free economy, is a more logical guide. It operates by the principle that we can concentrate on producing those items in which we have the greatest relative advantage and leaves to trade the acquisition of those items in which we have a comparative disadvantage. Departures from the automatic operation of this principle of economic efficiency cost us some of our economic well-being, and have been acceptable to people who understand these principles only because we do not live in a world truly at peace. Surrendering some trade freedom and hence maximum economic advantage has been necessary in a divided world.

(*d*) *Low-wage countries and high-wage countries are not barred from carrying on mutually beneficial trade.* This is because wages are only one element in total money costs, and money costs or prices must be compared through an exchange rate which is subject to adjustment. Further, low wages do not necessarily mean cheap labor cost per unit of output, for low wages are generally a sign of low productivity. Relatively plentiful labor is paid low wages, but usually produces so little per capita output that the price of a final product is just as likely to be higher as it is lower than the product price in a high-wage country. But low-wage countries do tend to have a comparative advantage in the production of goods which require much labor, while high-wage countries have a comparative advantage in the production of goods which require a higher proportion of capital or material resources in their manufacture. Absolute advantage in all lines of production is not found in practice and is meaningless as a concept. Low wages abroad tend to limit trade, however, because they usually imply little purchasing power for imports.

(*e*) *Although the profitability and employment levels of some individual home industries are markedly affected by trade, cheap foreign labor is not a threat to the interests of American labor as a whole.*[1] The reason for this is not only a matter of the high productivity of American workers and the general efficiency of our country which is the greatest in the world. It is also a matter of the mechanics of international trading and financial transfers. Other countries will not give their goods to us for long without wanting repayment in kind. But in fact, if foreign labor cost nothing at all, their products would be even greater bargains to improve the living standards of all Americans. Cheap foreign labor incorporated in imports has the same effect on our national economic well-being as do improvements in our technology which have been the basis of our rising living standards. Cost-cutting technological improvements like cheap imports have freed American workers from onerous work, raised real wages, shortened working hours, and have opened the door to newly whetted appetites for a greater output of goods. In the interest of an expanding economy, we long ago abandoned the fallacy that there is only so much work to do or so many goods that can be sold.

We are mindful of the problem of substandard wages in other countries from a humanitarian viewpoint, and want foreign wages to rise as rapidly as increasing productivity will allow. This is important to world peace. We know that such increases also will expand foreign markets for consumption, but if wages abroad are forced above levels justified by productivity, the result will be wasteful inflation. In any case, the definition of substandard wages must be in terms of foreign conditions, not in comparison with our own, which would rule out virtually all trade if rigorously applied. To the extent our interest in the welfare of foreign workers is humanitarian, we should not refuse to accept imports from so-called substandard-wage countries as that will take away much of the opportunity for improvement of their well-being.

We are also mindful that the prevalence of lower wages abroad is a very real problem to certain individual American industries, and we will treat their problems later in this report.

(*f*) *Although there are conceptual and practical difficulties in making absolute comparisons of cost and income among countries, it is possible to measure small yet significant changes in rates of economic progress, and these measures are extremely important to policy guidance.* These progress comparisons are easier because they do not require translation from one currency and economy to another of a different structure and institutional setting. It is of limited significance statistically whether the richest country is 10 times or 30 times as well off per capita as the poorest country. But a change of 1 or 2 percent in annual growth rates can be highly significant as well as being measurable over time. There are enough data now available to make reasonably valid short-run growth comparisons in most of the developed countries of the free world; the problem is considerably more diffi-

[1] Senator FLANDERS. Although I agree with the points made in this section, I feel that cheap wage competition creates greater problems for American producers and workers than this section implies. It may be true that low wages are often a sign of low productivity, but low wages also permit some producers to gain a competitive advantage. We have yet to assay the effect of Japanese competition on our textile industry which is a major, not minor, sector of our economy.

cult in the underdeveloped countries which lack comprehensive statistics or in the totalitarian states which deliberately mask or distort information.

Absolute comparisons among countries of marked differences in institutional structure and standards of living, or even over long periods of time within single countries experiencing growth, are not only difficult to make for lack of uniform data compilation but conceptually present almost insurmountable obstacles except by making extremely arbitrary and hence challengeable assumptions. And yet all too often, this latter type of measuring is practiced in the name of scientific cost comparison for trade-policy purposes.

On the other hand, relative growth comparisons are extremely important because they represent the summary economic measure of the struggle of the free world, both developed and still underdeveloped countries, to maintain the lead necessary over the Sino-Soviet bloc if our system is to outweigh Communist blandishments and to be stronger militarily as well. If our measures of growth rates do not reveal at least as much progress as the forced development of the totalitarians, we would be identifying a trend toward some future time when they could overwhelm us. We do not intend to be overtaken, and must have these data as a guide to our policymaking.[2]

III. FLOW OF TRADE AND PAYMENTS

(*a*) *The very nature of trade requires that over a period of time, imports must bear a close relationship to exports, defining both in broad terms to include goods and services.*[3] There is no reason why this balancing needs to be bilateral between pairs of countries, and indeed generally efficiency is served by multilateral flows as shaped by market forces. The balance of visible (goods) and invisible (services) trade of any country with the rest of the world will be held to a near equality except in the very short run by inevitable technical requirements which limit departures from this equality in definite ways. Whether a country's policies are wise or foolish, it cannot have a deficit in its trade in excess of its available holdings in foreign bank accounts and investments, or willingness to export gold; or its willingness to receive foreign investments and deposits, and the willingness of investors in other countries to make such transfers; or its willingness to receive gifts of aid, and the willingness of other countries to grant such aid.

It follows that long-run policy must accept the general proposition that imports and exports of goods and services will have to be roughly equivalent in value, although there are some perfectly logical qualifications of this statement which are also required. We must not only be concerned with the adjusting of the balance of payments of a country with the rest of the world; we must inquire at what levels of trade, production, consumption, and investment, and with what political consequences these adjustments take place. Some lack of balance in trade as a means to transfer capital between countries is perfectly proper when the capital transfers are for purposes which are desirable,

[2] The Joint Committee staff study, Trends in Economic Growth: A Comparison of the Western Powers and the Soviet Bloc, was prepared in recognition of this need.

[3] Senator FLANDERS. It was brought out in an earlier committee hearing that under possible circumstances the balance would have to be made by inflation if the flow of trade were insufficient.

such as to speed economic development or to earn a better return by more productive employment of resources than an absence of international investment would permit. As we view policy toward the balance of trade, we want to facilitate such useful capital transfers, not remove all deficits and surpluses in current accounts. Unilateral transfers or gifts represent an alternative method of balancing trade, and in fact represent the reason for some trade imbalances. Such transfers have been a prominent feature of post-World War II trade and have been designed to serve political, military, and humanitarian ends rather than purely commercial. Although the amount, form, and direction of such aid are subject to disagreement, there is no quarrel with the principle that such aid may be extremely useful to national policy objectives.

(*b*) *The prewar patterns of trade which gave relative stability have permanently shifted to new patterns and can be expected to undergo further modification.* Substantial progress has been made in the postwar readjustment necessitated by the temporary shifts occasioned by the dislocations of World War II, but new patterns will persist as former sources of raw materials diversify their economies and industrialization becomes more widespread. This will continue to require adjustments in trade policies, exchange rates, and investment flows. Patterns of trade always have changed to fit new technologies, growing populations, exhaustion of old resources, discovery of new resources, obsolescence of plants and methods, and new consumer tastes with consequent dislocation. Probably the adjustments now are somewhat harder to make because of the forced speed of economic development in many parts of the world which now have more independent control over their internal policies. Another factor which has added to the economic difficulties of adjustment has been the effort of the Communist countries to carve out a separate trading and economic planning bloc, a bloc which they are trying to expand in size at the expense of the free world.

(*c*) *The balance of payments under any trading and exchange system will adjust; the real question is to select the adjustment appropriate to the circumstances of pressure on the balance.* In the short run, the adjustment may take the form of gold and short-term investment flows, or of changes in interest rates to encourage counterflows of funds. The relative amounts of imports and exports also will be altered by changes in price levels, changes in income and employment, changes in exchange rates, the imposition of trade and currency controls, or through foreign borrowing and grants of aid. Several of these policies may operate in conjunction, and each has its advantages and disadvantages in particular situations. Therefore prudence requires an examination of the circumstances rather than a blanket prescription. No adjustment is guaranteed to abolish the underlying reason for pressure in every case. Although the adjustment will occur regardless of the wishes of a country, public policy can in considerable measure determine the form of the adjustment and hence alter the balance of desirable and undesirable effects. Internal monetary, credit, and fiscal policy will be crucial to the effectiveness of balance-of-payments policy.

It can be noted in passing that the so-called dollar shortage in the accounting sense is really the obverse of the "foreign aid" coin.

(*d*) *Devaluation of exchange is not a universal solution to problems of pressure on the balance of payments.* It makes very good

sense to use it as a remedy for overvalued currencies as may be associated with noncompetitive prices caused by a previous inflation now ended and where deflation threatens. The alternative, deflation, may imply intolerable unemployment and reduced production. On the other hand, if the cause of price noncompetitiveness is continuing inflation, or if there are large liquid balances available to be spent on goods, devaluation will not solve the fundamental cause of imbalance, and will have to be repeated as prices continue to rise. Nor does devaluation correct any widespread real need for imports of essential materials domestically in short supply in those situations where export volume cannot be increased substantially. Its effect is to worsen the terms of trade. Further, devaluation may be competitive, and therefore not correct the situation intended if other countries match the cuts made by the first. Devaluation should be used by other countries only where it is an appropriate remedy as qualified above, and we do not advocate its universal application to solving pressures on the balance of payments. The new par value should be one which restores a competitive position but does not overcompensate to give an unfair advantage; it should be a rate which will not put undue stress on the balance of payments over a period of several years.

(*e*) *No universal judgment is possible in choosing between fixed and floating exchange rates, although there is a prima facie case in favor of reasonably stable rates.*[4] Fluctuating rates make possible a rapid adjustment of the balance of payments, and may have the advantage of reflecting a free market judgment on the current value of each currency for trading purposes. But that automatic adjustment of the current account of the balance of payments by this means can be secondary to other economic and political goals was made clear earlier in this report. The former automatic gold standard strictly limited fluctuations in exchange rates by the adoption of fixed gold definitions of currencies so that the price of exchange could move no farther away from the par than the gold points, or cost of shipping gold. This was a recognition of the importance of exchange stability to the orderly calculation of business expectations and hence to a large and regular volume of trade. We have seen also that the automatic gold standard is not likely to return, and had strong disadvantages as well.

However, governments can maintain fairly stable rates, with fluctuations held to narrow limits and these slight changes of price used as a guide to counteraction. Such control recreates the major benefit of the former gold standard's exchange stability without its limitations on freedom of action in individual nations' economies. But from this it does not follow that any stable rate a nation may choose to try to maintain is necessarily wise and helpful. If the rate requires restrictive trade or exchange controls to hold it at an artificial level, the freedom of trade is reduced to the possible detriment of general economic efficiency. The goal in picking a rate which is to be maintained is to find one that meets the needs of trade over a period of time without

[4] Senator DOUGLAS. Although this section carefully qualifies its view of the relative merits of stable and fluctuating rates, it advocates stable rates as essential to orderly trade. I would personally feel that the disadvantages of fluctuating rates have been overplayed and their merits as a means to adjust pressure on the balance of payments understated. Fluctuating rates would permit a much quicker adjustment of the balance of payments and it would put pressure upon a country not to let its costs of production rise too high. We should remind our English friends of this when they try to protect themselves against American competition by discriminating against American imports. Otherwise we may be asked to underwrite a permanent and possibly growing discrimination against American goods inconsistent with the desired policy of freer world trade.

major restrictions on the use of exchange. Even so, the country concerned must have working reserves of gold or hard currency sufficient to cover temporary drains.

Although the present systems of exchange-stability measures are not automatic in the degree true of the former gold standard, there are some points of similarity. The former system did not automatically solve all problems associated with pressures on the balance of payments. When pressures were prolonged, if price and income level adjustments were either ineffective or interfered with, a given country was forced off gold or had to select a new lesser gold definition of its currency. Today, too, a rate may be picked that is unwise, or conditions may change so that it is no longer maintainable. If a government wishes to hold the range of price fluctuations of exchange to a narrow limit, it must be prepared to step into the market to buy or sell gold and foreign exchange holdings in the same manner as happened automatically in earlier years. If these short-run correctives prove inadequate, then the government concerned must look to other measures. These include the possibilities of depreciation, exchange controls, internal economic adjustments, or, of course, capital transfers and foreign-aid programs, as fits the particular situation.

(*f*) *Multilateral trade offers the widest opportunities for gaining access to raw materials, cheap manufactured products, and useful market outlets.* Furthermore, multilateral trade implies the best opportunities for efficient allocation of resources and energies, to encourage opportunities for progress throughout the free world. If individual businessmen and companies are allowed to carry on trade without restrictions which approximate bilateral settlement or barter, the same benefits of efficiency become available internationally as most Americans believe have been the strength of a free-enterprise economy at home.

(*g*) *Currency convertibility is important to the absence of discrimination necessary to the attainment of the benefits of multilateral trade.*[5] There are many definitions of currency convertibility, but the essential element from the viewpoint of efficient use of resources is that there not be controls which distort the most advantageous flows of trade. Absence of convertibility, depending upon the strictness of controls, often denies access to markets where the best bargains may be available, and hence reduces efficient allocation of resources in the interest of greater economic well-being.

Restrictions on convertibility may be justified under rather special conditions. These include periods of war, and where unlimited use of exchange may be detrimental to our political well-being, as in the case of transactions with the Sino-Soviet bloc. They also include temporary panic conditions when a sudden outflow of short-term funds does not respond to the normal correctives to the balance of payments and are a threat to ordinary trade. They may also be necessary to ration the use of limited and not easily enlargeable supplies of foreign exchange.

[5] Senator DOUGLAS. I want to make absolutely clear the distinction between exchange convertibility, which this section recommends, and return to a domestic gold standard, which I do not recommend. Gold is a useful commodity for making international settlements and as a standard of reference in defining pars of exchange if it is desired to have such stable rates, but there would be distinct disadvantages in tying domestic monetary policies to the former gold standard.

Fortunately, considerable headway has been made through international cooperation and economic recovery toward a return to full convertibility. This is evidenced by the shrinking differences which exist between free market and official prices of the principal currencies, the relaxation of restrictions on the use and transfer of exchange, and the reappearance of a free gold market in some parts of the world. This should make possible significant and continuing progress in removing remaining discrimination against dollar imports. The United States wants to facilitate the early restoration of convertibility, but the precise timing is up to the other governments involved. We do not want de jure convertibility at the price of other restrictions on trade.

(*h*) *Looking back on the recent past, it is hard to insist that foreign discrimination unnecessarily limited the total volume of American exports, but we must insist on fair treatment in the future for our goods.* This is clear because other nations have been willing to spend all the dollars they could earn or borrow, other than for necessary additions to working reserves. Therefore, restrictions on the use of dollars for the purchase of goods have been more important in influencing the commodity characteristics of United States exports than in changing the total volume of such trade. Given the purchasing power these countries possessed, they bought from us all they could afford. This suggests that removal of discrimination against dollar exports will not automatically boost our total sales abroad. But at the same time, we do not want to see restraints continued on trade beyond the time they are essential to meeting very special conditions. Until discrimination ends, it is hard to predict how much new and useful trade might be created. To accept such controls without question is to deny the effectiveness of free-market mechanisms in guiding the flow of trade toward greatest economic efficiency and well-being.

(*i*) *The United States has been truly free of worry regarding pressure on its own balance-of-payments position, with important consequences for the framing of economic and political policy both at home and in relation to the outside world.* This has given us a freedom of action probably no other country possesses, and enables us to show a leadership in world economic affairs few other countries in the world are in a position to emulate. The causes lie in our high level of economic development; the great rate of American technical progress and efficiency, with its resulting demand for our products abroad; our relatively slighter tendency toward price inflation than is true of most other countries of the world; and even, it might be added, because of our vast gold reserves.

Where we import and export an equivalent of less than 5 percent each of our gross national product, we have a gold reserve equal to 100 percent of combined imports and exports per year. The second greatest trading nation, the United Kingdom, exports an equivalent of 22 percent of gross national product and imports 26 percent. Its gold reserve is equivalent to only 13 percent of combined annual trade. This illustrates our greater freedom from concern over trade flows.

The only other great power which may be able to act without weighing the adverse impact of current policy decisions on its balance of payments is the Soviet Union. This is not only because it holds an unknown but probably large gold reserve, but because whenever it suits Soviet political ends, that country can adjust its internal economic

affairs without as much regard for the well-being of its own people. Communist willingness to subordinate economics to political-military ends is a major element in world economic policy which must be recognized if it is to be countered successfully.

IV. DOMESTIC REACTIONS TO FOREIGN TRADE

(*a*) *International and domestic trade afford similar advantages through division of labor, specialization, and mass markets; both carry the disadvantage of interdependence, but such interdependence is an inherent part of modern technical and economic organization.* If international trade is to be singled out for special regulation, the burden of proof for the necessity of this regulation rests on those who would depart from the presumptions that free markets work best. We view the economic purpose of trade to be the enhancement of living standards. There are reasons for sacrificing these standards to other social goals, but they must be made explicit. Few would deny that the economic strength of the United States rests upon the free flow of trade within its 48 States despite their variations in per capita income and endowment of resources.

This large free-trade area has brought competitive pressures on specific industries in certain parts of the country. But important as these pressures may be, they are minor compared with the cost that a system of trade restrictions to guarantee local markets would entail. Here at home even though we have a number of types of departures from automatically controlled market allocations, we accept free markets as the preferred form of economic organization. Such exceptions as have occurred have had their costs, and where deliberately chosen were in the interest of some special goal.

Likewise, there may be reasons for manipulating international trade that are acceptable to the people as a whole, but it must be recognized that such manipulation has an economic cost and, where possible, our policies should bring into the open what the costs involved are so that rational choices between economic efficiency and other goals can be made.

(*b*) *The United States standard of living rests basically upon our productivity, not upon protective measures.* Although there are short-run distortions and imperfections in the market process, generally the shares of wages, rent, interest, and profits have been determined by the relative availability of labor, land, capital, and business enterprise in the economy in conjunction with the demand for their services. As factors in combination have become more productive, their earnings have gone up. If we were to argue that our standard of living rests upon protection, then we could assume that greater restriction of trade would make us even more productive. But this is not so, for productivity rests upon the quality and availability of our machines and other capital goods, the richness and location of land, the skill and willingness to work of our labor, the managerial ability and incentives of our business leaders, and the general institutional setting of our society including the role of government. A poor country will not make itself rich by raising trade barriers, nor will a rich country be better off for doing so.

The thought that the demand for all American labor might be displaced by foreign-made products does not face the question of how

we could obtain these imported goods for long without exporting, nor is it true that foreign labor is across-the-board cheap enough per unit of output to make foreign competition that effective. To the extent that foreign prices are lower than ours, whether the cause is cheap labor, or abundant resources, or better machines, or merely undervalued foreign exchange, such imports afford an opportunity to raise the American standard of living still higher by giving us more for our money, and releasing purchasing power for other home products we cannot now afford to buy.

We have conceded that there may be legitimate reasons for disregarding our own economic advantage, and lowering our standard of living by using some trade protection. But that there is such a cost to these policies as are associated with defense or with minimizing dislocations in home industries, must be recognized and taken into account when policy is being planned.

(*c*) *It is hard to see why consumers should not have the right to choose such goods as are desired, without regard to their origin or their foreign cost.*[6] Until we presume to replace freedom with a controlled system where people are no longer their own masters, this must be so. No group of producers should be allowed to have a vested interest in the right to dictate what our people shall consume. The excuse that such a vested interest is essential to maintaining employment is fallacious, and was not allowed to block the introduction in the past of the automobile to the detriment of coachmakers, the electric streetcar to the detriment of horse breeders, or mechanical refrigeration to the detriment of ice deliverers. Some industries can adapt to the will of the consumer who in a democracy is king. Others have not adapted, and have become extinct.

In a country as rich as ours with shortened working hours and a complex technology at our command, including modern transport to deliver the luxuries of the world to us, there is no reason why we should not spend our money if we choose for foreign sports cars, lightweight bicycles, handmade laces, particular wines and cheeses, jeweled movement watches, or hand-cut glassware.

Our ability to command exotic products is one measure of our progress and freedom from previous limitations in the pursuit of happiness. Let our home producers use their admitted skills in advertising to compete freely with their foreign rivals. For a Government official to make a moral judgment on how we ought to spend our money is an invasion of liberty and privacy which is acceptable only where obvious public harm follows, as in the uncontrolled use of narcotics. Interference with free consumer choice must rest upon very compelling grounds, and if these relate to the short-run problems of displacement in certain industries or localities, a solution other than restriction of consumer freedom should be chosen.

(*d*) *Imports and exports are both important to the economy, and neither deserves artificial stimulation or restraint for its own sake.* Trade is not an end in itself, but is a means to other ends. Imports we need are those goods which we cannot produce in this country, goods which we can produce only at significantly higher cost, and

[6] Senator FLANDERS. As important as consumer choice may be, most of us are producers too, and our trade policies must be designed also to make sure that our people have the opportunity to earn the money which is to pay for desired purchases.

goods which though we can produce at reasonable cost are ones in which we have a comparative disadvantage. We also want to import some goods not on the basis of costs or availability at home, but simply because of consumer preference for foreign brands or specialties.

Exports represent an important source of employment and profits in certain lines of production, but they are not an economic end in themselves. They may have important contributions to make in strengthening or enriching other countries just as our imports are important to us. From our own point of view, exports in the long run are made in order to pay for desired imports or to tranfer capital abroad which eventually will earn the means to pay for desired imports.

If we are dissatisfied, however, with the current excess of exports over imports, it would be better to expand the volume of imports which we accept than to curtail exports based on normal commercial trade, on desired foreign investment programs, or on aid to meet specific foreign policy goals. After all, export industries if suddenly restricted would face the same kinds of displacement problems as do domestic industries hit by foreign competition. Artificial manipulation of either imports or exports distorts the freedom of market choice and efficient allocation of resources.

(*e*) *Tariffs are a clumsy weapon for trade protection; quotas have even worse economic effects; administrative protectionism may cause the greatest problems of all.* The historical use of tariffs to raise revenues is no longer a factor in United States tariff policy. Tariffs not only raise the price of foreign goods to our consumers, but usually are accompanied by higher prices of domestic goods protected as well. They represent a burden on our more efficient industries, and drag the economy down by encouraging inefficiency. Under a tariff umbrella, not only is aid given to the firm which needs help, but the company already doing well can raise its prices, too. Marginal producers who previously could not command resources in competition with more efficient industries now begin to operate, and those at the new margin now can argue they, too, need protection. This process could continue logically until there is no trade at all, except where there is no would-be producer at home. And who is to say that there are not those who might not be encouraged to grow domestic coffee or mine very thin ores. This process of retreat from efficiency is limited only by the rebellion of consumers and the limited purchasing power of the people if more costly means of production are used.

In time of war, quotas on imports are the counterpart of necessary domestic controlled allocation. But, carried over to normal times, quotas are designed for a purpose similar to tariffs. They are worse because they may be insensitive to changes in the volume of demand, and to changes in costs of production and prices, and are almost always discriminatory in assigning shares of the market. A quota has the purpose of boosting the market price just as does the tariff. If consumer demand grows, except by specific administrative action there can be no increase in imports as even a tariff allows, and the only alternative is for the price to rise even more. Quotas imply the assignment of shares, and this inevitably means that choices must be made among countries of supply and individual traders. The opportunities for favoritism, for economic strangulation, for international hard feelings and reprisal, and for personal corruption are unlimited.

"Administrative protectionism" is a blanket expression that covers a host of devices. As much as anything, it opens the door to the capriciousness and the instability which were pointed out earlier to be the worst danger to orderly growth of trade. Sometimes this form of protection is either unwitting or deliberate cumbersomeness to regulations that add to the expense of trade to the point of being highly restrictive. This redtape involves both extra costs for complicated paperwork and long delays which increase the risks of heavy financial losses. Sometimes these devices are matters of inconsistency in applying complicated rules, variations among the practices at different ports of entry or even in a single port. Sometimes these are arbitrary rules of valuation which so interpret the cost of goods as to raise the tariff burden much higher than ordinary logic would interpret the law to intend. Sometimes by hiding behind perfectly valid sanitary and health rules, trade can be embargoed actually for the purpose of changing the competitive position of foreign industry to its disadvantage. In some parts of the world there is the added hazard of official corruption which can be a heavy burden on trade. The combined effect of these administrative rules is so to damage orderly trade, and prevent a reasonable development based upon calculable expectations, that by comparison a high but uniformly applied tariff would be a delight.

Although currency controls may be necessary in some circumstances, they have their price. Currency controls may combine on occasion the disadvantages of tariffs, quotas, and administrative protection. The use of multiple exchange rates can alter the price of individual imports as would tariffs. Exchange controls are the counterpart of quotas on merchandise imports but extend to all financial transactions. The administration of exchange controls frequently is arbitrary and discriminatory.

The principal point of all of these devices is that they restrict trade, which is the purpose their advocates intend. Any or all of them may have to be used under some circumstances. Only the tariff has been advocated by the United States Government as the normal means to be used for the protection of domestic industry.

(*f*) *Distinction must be drawn between the general or national effects of trade competition and the specific effects on individual industries.* Specific effects cannot be minimized and may require corrective action. But the general welfare in the long run must not be permanently sacrificed for temporary and localized expediency if the Nation is to prosper and grow. This requires a clearer appreciation of the national interest in selecting particular remedies to dislocations.

(*g*) *The immediate dislocations occasioned by import competition at worst cannot be a major factor in the dynamic United States economy, however serious they may be to individual industries and communities.* Our present trade-agreements law will permit only minor reductions in tariffs. Even if imports were to increase by as much as a billion dollars a year, which would not be a likely direct result of the present limited tariff reduction authority, that would be less than one-third of 1 percent of annual gross national product. The modified level of total activity occasioned by such change would hardly be measurable, and new imports would afford the means to finance additional exports. The importance of more trade lies not in its total volume but in its good effect on our efficiency and strategic well-being.

There is, of course, the danger that aggregate data will obscure acute individual situations, and these cannot be waved aside as unimportant. But it is clearly indicated that the measures required to relieve distress caused by trade freedom would be a very minor item of expense if the aggregate dislocation is so small. We must guard, however, against the tendency to blame all domestic dislocations upon foreign competition; if such claims are accepted uncritically, then the readjustment cost might be much heavier.

(*h*) *There is little doubt that dollars paid for imports into the United States will be disposed of in ways that will benefit United States economic activity.* Dollars paid out by United States importers ordinarily come back quickly to buy our goods and services, although in recent years other countries have used a small fraction of their dollar earnings to augment their currency reserves. Foreign dollar reserves, however, are not excessive, and the strengthening of such reserves, particularly in the sterling area, has been identified as a precondition for convertibility. These observations may be small comfort to individual displaced domestic industries, but they suggest that the whole economy is not likely to be dragged down by imports in the manner of those few industries which cannot meet foreign competition even in their home market.

(*i*) *Dislocations are a normal part of economic growth; those associated with trade are neither more nor less important in character than those of strictly domestic origin, and similar remedies seem to be in order for both.* The chief competition the depressed industries face is not foreign, but rather the greater efficiency of other home industries whose ability to pay high wages is better. The long-run remedies for depressed conditions are to improve methods of production and marketing, to create new products, and in some cases to shift to new locations. Short-run remedies will be discussed later in these findings.

(*j*) *The Government need not refrain from gradual and selective tariff barrier reduction simply on the grounds that someone might be hurt; but it may wish to consider concurrent steps to ease the adjustment.* Such gradual reductions should minimize any need for Government adjustment aid. Timing of tariff cuts to match growth periods in particular domestic industries would minimize the adjustment problem, too. There is a moral argument that if the distress has been caused by an arbitrary change of Government rules on imports, then public relief measures may be appropriate, within the limits of practicability. Not every case of distress can be readily solved by Government aid at reasonable cost in current taxes or in long-run effect on national economic efficiency.

(*k*) *There will always be competitive pressures in both domestic and foreign trade as costs shift, technologies change, resources are discovered and used up, consumer tastes vary, and economic development proceeds.* Serious acceptance cannot be made of plans which promise otherwise if the economy is to remain dynamic and progressive. Therefore, whether we restrict trade or whether we liberalize it, we can expect still to find some distressed areas and industries. This discovery should not be allowed to deny us the advantages of greater trade freedom.

(*l*) *A healthy and growing economy is the best overall antidote to the displacements of foreign competition.* Adjustments to new mar-

kets are easier to make under such conditions, and imports may be able to share a growing market rather than subtracting from domestic sales. United States domestic prosperity, if allowed to include access to imports from abroad, automatically eases the dollar shortage abroad and can spur progress in other parts of the free world. This, too, reduces strain on our economy by enabling reductions in foreign-aid expenditures which might otherwise have to be larger.

V. REGIONAL TRADE

(*a*) *Regionalism as a policy when considered as part of a larger plan of strengthening worldwide multilateral trade can be a force which is positive and beneficial; but regional trade plans which limit worldwide trade are more likely to be negative in effect and harmful to economic efficiency and well-being.* The judgment on the creation of trade blocs must be made in comparison with alternatives. Creation of such blocs would be superior to any attempts to achieve complete self-sufficiency in smaller units, but if such blocs are considered a substitute for even wider ranging multilateral trade, they have definite disadvantages. Some groupings created by measures to lower trade barriers may be beneficial to world trade as a whole. The test should be that those groupings and rules used which are trade creating are to be encouraged; while those which merely divert trade or restrict trade more are to be discouraged. The United States in its own continental trading area is testimony to the effectiveness of freer trade. But where blocs are designed to freeze out rival suppliers, and to deny access to raw materials and investment opportunities, then the seeds of future wars are being sown.

The greatest problem of restrictive and discriminatory regionalism is the existing Sino-Soviet bloc of countries which would offer us the choice, if they could, of strangulation as they take over a widening area, or of capitulation to their control.

(*b*) *Customs unions have advantages over most other preferential trading arrangements.*[1] The United States in a sense represents a very large and successful customs union. Small customs unions offer less advantage for marked economy and efficiency, so where possible unions should encompass large areas. As a practical matter, customs unions are hard to create because they involve all the pressures related to tariff reductions, and additionally require coordination of many economic policies beyond those of trade. In contrast to customs unions, many other preferential trading arrangements tend to raise barriers against the outside world rather than to cut barriers among each other. Further, they are often subject to change with consequent costs of dislocation of industry. Preferential plans raise serious questions of administration because they are discriminatory. It is necessary, too, to determine country of origin of assorted component materials in manufactures, and to apply appropriate different duties to these components, which is a cumbersome process. Multilateral trade and its advantages are inhibited when preferential groups seek special privileges to the exclusion of other nations. A customs union also alters

[1] Senator FLANDERS. At the Bilderberg Conference last August which I attended there was much approval of a European Customs Union and much discussion of the difficulties in the way. I called attention to the fact that these difficulties are those seen by American business in considering an effective customs union with the rest of the world and suggested that our hesitation should be viewed sympathetically.

competitive relationships but it need not cut off access to markets through the medium of new barriers.

(c) *European efforts toward economic integration are useful to world progress and prosperity, but must not be used to cloak continued or new discrimination against the rest of the world.* There is no reason why the United States should aid in making dollar discrimination respectable. European countries are now close to full convertibility, and should in time complete that process. If they can form a customs union, general or limited, that should be helpful, but the political difficulties standing in the way are formidable. It should be noted that the Western European bloc is really a world bloc, not a continental bloc, for it includes many dependent territories as well as being closely linked with the sterling countries. Now that Western European recovery has gone so far, there is no real United States interest being served by remaining discriminatory practices against our exports, except where the financial test permitting delayed convertibility makes it unavoidable.

(d) *The best hope for strengthening the Japanese economy must be its further integration into the trading system of the free world; neither a yen bloc nor partnership with Red China would serve United States, Japanese, and free-world interests.* The free countries of East Asia do not provide a large enough bilateral market with Japan to solve their mutual problems. However, such trade would go part way toward solving the problems of the area and every encouragement should be given to increased trade among these countries.

Japan would find trade with Red China less helpful than its former trade with Manchuria and China because many of the materials Japan needs most now are preempted for internal Chinese development. Full access to Red Chinese markets and resources could be obtained only at the price of political absorption into the Communist bloc.

It should further be pointed out that Japanese purchases from the United States continue to be severalfold as large as sales in this country. There is little likelihood that the United States can afford a sufficient market to solve Japan's problems by itself, but this is not reason to raise special barriers to trade. It does stress the wisdom of our policy of encouraging worldwide trade contacts for the Japanese.[8]

(e) *Trade policy with regard to relations with the Communist countries is not amenable to simple economic criteria because political and military considerations are more important.* It should be recognized that in total volume, trade with the Communist bloc is small, has shrunk as a percentage of total trade, and shows little prospect of growing to any significant degree. There are few real obstacles in the way of peaceful trade at any time that the Communists desire to encourage such trade and have exports to offer. But the free world cannot be expected to ship strategic goods which will strengthen the bloc's military power to make aggressive war. We recognize that trade with the satellites may be important to some of our allies, and cannot be ended. We further recognize that control of trade with the Communist bloc can be successful only as we have the cooperation of other countries. Offering alternative markets to our allies may

[8] Senator FLANDERS. The best expansion of regional trade in Asia would be to foster exchange between the food-surplus Southeast Asia and industrial Japan.

be a concomitant of asking them to restrict trade with the Soviet bloc or Red China.

We can trade with the Communist countries only when we are convinced the advantage to ourselves and our allies is greater than the disadvantages to our side.[9] This suggests that constant review of the effects of trade is required, and the test of what is strategic must depend upon the latest secret intelligence rather than on any permanent published list. As a case in point, agricultural surpluses from the free world might be regarded as "peaceful," or they might be regarded as an addition to the military food stockpiles required before the bloc can initiate war. Only continual orderly reassessment can answer such a question.

We do not believe that greater amounts of trade will of necessity ease East-West tensions because trade policy is centrally controlled by the Communist bloc for its own political and military advantage. One goal of the bloc countries is autarky and trade is turned on and off to suit their ends.

The individual businessman would have trouble developing long-run trade with the Soviet state trading organization because lack of data on Soviet needs, home production, and costs makes it difficult to judge either market expectations or the basis of Soviet price competition. Another hazard of doing business with the Communists is the absence of patent protection. This allows foreign purchases to be cut off as soon as foreign designs have been pirated and put into production if that suits their ends.

Another purpose of Sino-Soviet bloc trade with the free world extends beyond the filling of their strategic needs for machine tools, nonferrous metals, rubber, and similar items. They are also trying to reorient the trade of countries such as Indonesia, Burma, India, and Egypt toward the bloc. If that process is successful, such countries will find themselves integrated like the satellites into the Communist system. Their raw materials and food will strengthen Soviet power and they will be an outlet for surplus obsolescing armaments.

Our restrictions on strategic trade are a necessary negative and short-run policy in the struggle to keep the free world stronger than the Sino-Soviet bloc. We also need to use trade positively and to meet long-run goals in this same struggle.

VI. INVESTMENT, AID, AND DEVELOPMENT

(*a*) *Immediate postwar recovery is largely complete, particularly in Europe, and, barring new emergencies, the principal need today is the orderly development of unused resources and of the innate abilities of the people of the world to raise living standards and create a sense of progress.* Countries need not only to accumulate a capital stock but equally to improve the efficiency of their labor and the level of their technical development. Technical aid will require more time to become truly effective than was the case of postwar material aid.

(*b*) *Foreign economic development is important to United States growth.* Our policy cannot be guided by the fear that making our technology available will merely create rivals abroad. In the first

[9] Senator DOUGLAS. I am opposed to trade with the Communist bloc for reasons of national security and international morality.

place, we do not have a monopoly on either ideas or the means to make machinery. If we fail to meet the purchase needs of countries eager to develop, other suppliers will. In the second place, there is more to economic development than just supplying modern machinery. Often the most modern equipment does not bring anything like the same volume of output per worker as in the United States for a variety of complex factors. In the third place, whatever development occurs abroad, there will be many comparative cost differences which will remain, probably leaving as much reason to trade as before. In the fourth place, both experience and commonsense have shown there are more opportunities to trade with developed countries with purchasing power than with underdeveloped countries whose complementary relationship is one of exchange of raw materials for a limited amount of manufactures.

Therefore, it is in our interest, economically as well as politically, to see the rest of the world develop and prosper, too. But, at the same time, we should not give encouragement to ill-conceived, unbalanced development programs made possible only by restrictive trade practices which will distort efficient production in the countries wanting to develop. Programs which are formulated arbitrarily without regard to the most pressing needs and the capabilities of the country concerned will tend to retard progress rather than speed it, and will prove a heavy burden on the people of the country. In a spirit of cooperation, using both our own and regional or world organizations, we should supply that assistance which our own knowledge and experience have demonstrated will contribute to real and lasting progress.

There is no more economic reason why every small country should attempt to create within its own borders all the basic heavy industries than there is reason to attempt this within each of the 48 States. New industries and public works should be tailored realistically to the training, market requirements, and probable costs which are associated with these developments. Without condemning any region to dependence on single-crop exports, we should continue to foster international specialization in those cases where it is clearly superior in efficiency to economic self-sufficiency. By no stretch of the imagination can small countries or territories free themselves of interdependence with the rest of the world at reasonable cost to their people. Therefore, the goal should be to make the best of this and to guarantee that trade will not be impeded, rather than to sacrifice well-being in the interest of an illusive isolated prosperity which cannot in fact be attained. There is enough legitimate development work to keep the world busy for many decades.

(*c*) *Real investment takes place in the form of a flow of goods, although the directions of flow may be roundabout.* This is true of repayment of interest and principal as well. These conclusions have implications for the balances of imports and exports. A creditor nation eventually will have to accept an import surplus or see investments go into default. This day can be delayed by continuing to make new investments and by refunding old. Refunding can be perfectly good policy. But if investors should later want to repatriate their funds, only the equivalent of an import surplus will make that possible. Policy must be prepared to accept this eventuality.

(*d*) *As much as we may favor private international investment, it would not be realistic to assume in the foreseeable future that it will be adequate by itself to meet all the investment needs of the world.* Private investment has many advantages. It is more likely to be put into projects which can be justified on economic grounds by earning the highest possible return, which is the useful characteristic of the market system for allocating resources to those purposes which are most efficient in meeting human needs. Another advantage of some private investments is that they carry with them automatically the necessary technical knowledge the receiving country needs. Private investments may be less likely to carry the threat of political control with them, and also are more likely to be extended indefinitely, avoiding the complications of repatriation of capital which may be required of many public investments. It has been easier to encourage direct investments abroad than those of the portfolio type, and yet the latter have a very useful place which should not be neglected.

Private investment, however, is inadequate for the needs of the world for fairly obvious reasons. Foreign governments should recognize that United States investors continue to have good opportunities to make money at home despite our vast capital accumulation. There is little practical reason why they as individuals should want to accept the risks of foreign investment in many parts of the world for the slightly higher returns that may be offered. Many foreign governments want to hold down interest rates and profits in their territories, and yet the foreign investor faces the risks of political instability, arbitrary changes in foreign laws, and even expropriation, not to mention exchange controls which may limit the use of his earnings.

Often the development needs of other countries require heavy investments in social overhead projects which are important to national growth and productivity. These include such projects as railway and road building, port construction, improvements in water supplies, sewers, public health, and education. There are places where either private funds are not sufficient, or are not forthcoming at all where such investments are nonetheless important to the developed countries of the world both for economic and political reasons. Public investment becomes unavoidable. Administered with understanding, it can guard against the pitfalls of poor planning and waste, and the dangers of excessive interference in the internal affairs of the recipient countries.

(*e*) *Investment can be mutually advantageous to the countries involved.* The idea that foreign investments are exploitation of the borrower is an unsound generalization. Investment makes possible development that otherwise would be either impossible or delayed. Repayment of interest is made out of the surplus of production created by the investment. The foreign investor does so for the same reasons he would at home—to earn a future return. Making such an investment creates an export surplus with expansionist effect upon our economy. The repayment of interest in the form of imports is not a drag on our economy. This is because the means for the purchase of the imports came from the foreign earnings, not as a subtraction from domestic purchasing power.

(*f*) *Not only must private investments be supplemented by government loans in some circumstances, but there is a specific place for*

grants of aid as well. The point has been made already that many of the development needs of the world are located geographically and politically in places where there is little inducement for private investors to place their funds. Government investment may be able to meet some needs in terms of size of credit, length of time, and lower interest rates that would be out of the question otherwise. The reasons for such government loans may be political, or they may even be very sensible economic risks that will pay definite economic rewards in the long run. Loans that can be repaid should be used where applicable, both in the economic interest of the lender and for the pride of the borrower.

But there are also circumstances in which it is not realistic to consider government transfers as something that can be repaid, and to pretend that such a transfer is a loan is unwise. During World War II, the United States recognized that although returnable hardware could remain our property, there was little advantage in adding to postwar dislocations by extracting promises to repay consumable goods. They became one of the costs of the war. In similar fashion, the UNRRA program was a humanitarian plan to meet the obvious immediate needs of hungry and homeless people. There was no thought of concrete repayment.

Aid programs are designed to meet specific national political, social, and military goals. They do not need to meet the test of investments which must generate a means for repayment. But they do present serious problems of measuring their benefits against their costs, and they compete for limited resources with other worthwhile projects. Such programs must be assessed in the light of their urgency at the time they are considered, and in the light of the alternative long-run consequences of different courses of action open to the Nation. Foreign aid is one of the devices important to maintaining the lead of the free world over the Communist bloc.

VII. UNITED STATES POLICY

(*a*) *The most significant conclusion on United States policy of the last 20 years is that we have managed to stem the world tide of rising controls on trade; that course must not be reversed now.* Although we appear to have cut many duties up to 75 percent from the peak rates of 1930, most of these cuts have been in items which would not interfere seriously with the existing pattern of production in the United States. From this point on, it will be harder to make substantial cuts in tariffs without arousing more domestic objection. We must strive to hold the line against any reversal toward greater restriction, and continue to encourage behavior on the part of other countries to reach a similar degree of liberalization, if it has not been attained. Other findings of this report recommend we must do even better in the national interest than this.

(*b*) *The basic choice open to the United States is one of international cooperation or of self-containment; only the former is a practical, long-run choice.* Because our long-run policy cannot be built upon self-containment, we must design policies which advance our interests within the framework of cooperation. We must not throw away the long-run benefits of consistent policy with a series of temporary, emergency solutions based upon current expediency.

(*c*) *Our goal is to see the United States secure in a world of developing democracies devoted to peace and prosperity.* Our security can be assured only in a peaceful and prosperous world, where the benefits of progress are shared by all. We use the terms "democracy" and "peace" in the Western context, not the Soviet. A liberal trade policy is essential to the attainment of these goals, and a rising living standard is the economic measure of such progress both at home and abroad. Freer trade of itself will not guarantee peace, but will remove some of the economic causes of war. Even more to the point, if freer trade strengthens the non-Soviet world as it should, the likelihood of war will be reduced.

(*d*) *Tariff reductions should be gradual, and selective, and timed to fit the conditions of business.* There is no serious support for sudden abandonment of all duties. When reductions are considered it should be kept in mind that prosperous and dynamic industries can best withstand foreign competition. It would seem poor policy to apply reductions indiscriminately to industries which are in a depressed condition. The mobility of labor and resources to find other employment should be a consideration in the timing of reductions, and in some cases the speed of duty reduction can be linked to the rate of outflow of labor from our relatively less efficient industries to other jobs. Although blanket rate reductions on all commodities are not commended in general principle, the existing authority to reduce rates by 5 percent a year of present rates for 3 years is not likely to have much effect either way. A new and broader authority to cut rates in accordance with the criteria listed above should be granted under the Trade Agreements Act.

(*e*) *Although the United States has much to gain from its own liberalization of trade regulations, it should press as hard as possible for most-favored-nation reductions of tariffs, as well as continuing to insist on removal of quotas and relaxation of exchange controls in other countries.* This will have the advantage of helping American exports, and also will help foreign countries to expand their own export markets in all parts of the world, rather than depending too heavily on the United States market. To the extent that American negotiators are already pressing as hard as they can for such foreign concessions, this should be brought to public attention in greater degree. Just as domestic industries are given opportunity to testify on expected import competition, so, too, should exporters have ample opportunity to call attention to foreign concessions they desire.

(*f*) *Participation in the General Agreement on Tariffs and Trade, and membership in the Organization for Trade Cooperation are in the interest of the United States.* Such multilateral negotiation offers the best opportunity for widespread reductions of trade barriers, puts countries maintaining quotas and exchange controls on the defensive, obligates them to remove quota controls without any tariff concessions being required in return, and minimizes the danger of tariff wars. The GATT does not involve new principles of trade not already contained in our reciprocal-trade pacts with individual countries. It centralizes the negotiating process in the interest of simplicity and maximum concessions from all other nations on a most-favored-nation basis.

The GATT has been able to settle long-festering trade disputes that seemed otherwise incapable of solution. It promotes the very condi-

tions which allow removal of quotas and exchange restrictions. If a participant decides to withdraw a concession, which it can do, it may suffer equivalent withdrawals by other countries, but these counteractions are limited to an amount proportional to the harm of the first withdrawal. This contrasts with earlier times when concessions could be withdrawn without giving any reason, and reprisals could become competitively worse. Even though freedom of action is left to the members, the general effect of the GATT has been to bring much-needed stability to trade to a degree not seen in decades.

The United States is such a key force in the world that its attitude toward the GATT and OTC will determine the fate of those organizations. The OTC has no supranational powers, and merely provides a small secretariat for the work of the GATT and a system of reporting on changes in trade restrictions and on other trade matters. If the United States does not join the OTC, other nations of the free world will judge that we have decided that it is inappropriate for this country to participate in continuing international discussion of tariff and trade matters. It should be kept clear that the GATT represents contracts to cut tariffs reciprocally. If these agreements are broken or withdrawn, member countries are not forced to follow GATT dictates; rather, equivalent concessions are withdrawn. No existing constitutional power is taken away from the United States Congress, which can override any agreement made under the GATT.

The GATT has permitted some exceptions in the form of quotas and currency controls to its program for reducing trade barriers. The permission to developing countries to use special controls, although it could be abused, is consistent with our interest in spurring economic development abroad. The currency discriminations of countries are largely a reflection of balance of payments difficulties which only now are being eased. The United States has been allowed a special dispensation to impose agricultural quotas to assist the domestic-support program. This country also has been the source of the exception clause which allows withdrawal of concessions as provided by the escape clause of our Trade Agreements Act. Finally, the United States seems to be working hardest to take exceptional action to raise barriers to trade liberalization when national-defense interests so dictate. All of these exceptions weaken the effectiveness of GATT, but are preferable to having the same restrictions on trade without a forum for their consideration.

The efforts of the GATT to end quota and currency controls as well as to cut tariffs are now of special importance. Tariff cuts by other countries, which earlier were made meaningless by other controls, now have become significant as many of these other controls are abolished or relaxed.

The work of GATT and the OTC is complementary to the activities of the International Monetary Fund and the International Bank for Reconstruction and Development. There is consultation between the Fund and the GATT so that they do not work at cross purposes or offer different policy recommendations.

(*g*) *It would be in our national interest to press for free convertibility of exchange at the earliest opportunity when stable and main-*

tainable rates have a reasonable assurance of being achieved.[19] Our major concern in this regard is to end discriminatory trade practices which inconvertibility fosters. Stable rates are necessary to creating realizable expectations from trade and represent a worthy goal. But even freely fluctuating rates dictated by the market, unless the swings are extreme, have advantages over the discriminations implicit in fixed rates held at artificial levels. The judgment must, of course, be couched in terms of the circumstances. There are times when controls to prevent flight of capital or to ration limited resources of exchange for essential imports are very necessary. We cannot insist that sovereign powers follow our preferences, but we can urge in a spirit of mutual interest that particularly the sterling area and the countries of Western Europe restore full de jure convertibility with the dollar as soon as conditions outlined in this section can be met. This would be a much more simple step today than was true earlier because of the degree of Western European recovery. Confidence in these currencies would be strengthened even more if there were the assurance that rates could be kept stable and trade proceeds be made convertible without restriction. Full convertibility and stable rates would allow more completely the allocation of resources on the basis of comparative-advantage principles, to the mutual benefit of all the trading countries. The risk of a run on a particular currency would be minimized by the very knowledge that all major currencies would be translatable without restriction. Successful convertibility depends upon prior solution of major balance of payments difficulties, the selection of a suitable rate, and holding sufficient reserves of gold or hard currencies to cover temporary reverses. It may be that sterling is not yet supplied with sufficiently large reserves for this purpose.

(*h*) *There should be a reexamination of the criteria used in judging the resort to use of the escape clause and peril points of the Trade Agreements Act.* Even if one grants the principle that an occasional change of mind on tariff concessions may be appropriate, the present escape clause is too sweeping in its opportunities to withdraw tariff reductions. The ever-present possibility of its use reduces the sanctity of any bargains we make with other countries. Foreign businessmen would be foolish to expand their American sales at any great investment on their part if the result would be to have the escape clause invoked. Other solutions to the problems of distressed domestic industries would seem to avoid the repercussions which follow escape-clause actions. These repercussions can greatly weaken world progress toward expanded trade, for other countries have an equal opportunity to use this device against their competitors anywhere, including the United States.

If the escape clause is to be applied, its use should not be authorized in the following situations: (*a*) when the domestic industry affected by foreign competition is still growing and expanding its markets; (*b*) when only a minor commodity or small group of commodities produced by complex industries are affected at a time these complex industries are doing well in other major lines (usually such industries

[19] Senator DOUGLAS. I believe strongly enough in the advantages of fluctuating exchange rates that I would not insist on delaying exchange convertibility until there was a certainty of being able to maintain a stable rate. We should move more boldly for convertibility, and adjust pressures on the balance of payments by letting the exchange market set its own levels.

can shift the composition of their output to their more competitive lines); (*c*) if imports constitute less than 10 percent of domestic sales. Imports of so low a level may be serious to individual firms but should not be thought as destructive of an entire industry.

When the escape clause is applied, it should be considered a temporary reprieve while other solutions are sought, not as permanent protection. A time limit for such a reprieve might be made a part of the action, with the provision that the original lower duties will be restored at the end of the period.

The peril-point provisions may also be unduly restrictive of trade by tending to limit tariff reductions to a degree not required by protection of domestic interests.

(*i*) *Quirks in our laws should not be allowed to dominate trade policy in a manner never intended by the Congress.* The Antidumping Act of 1921 was intended to control discriminatory pricing policies predatory in character by foreign suppliers against United States producers, if it could be shown that such lower priced imports were damaging to the American industry concerned. For many years this law was administered by the Treasury Department. Treasury still determines the existence of a price differential, but the determination of injury now has been transferred to the Tariff Commission.

A recent decision on cast-iron soil pipe (investigation No. 5 before the Tariff Commission) has followed a line of reasoning which if applied universally could negate much of our reciprocal program of trade liberalization. In this remarkable case, the challenged imports constituted no more than four-tenths of 1 percent of domestic production of cast-iron soil pipe, and the domestic industry during the period of this importation had expanded its production, sales, capacity, and prices. The Tariff Commission reached its conclusion regarding injury by deciding that the approximately 8 percent of national production located in California constituted a separate industry. But only one California producer who was represented at the hearings had shown losses during the period of imports, and these losses apparently were not the first he had experienced. A further circumstance of Tariff Commission findings on all antidumping cases is that the Commission is not required to make public its data and reasoning related to the decision made.

Some price differences are a normal occurrence in trade. If each time that this occurs and there is also a marginal domestic producer, then the penalties of the Antidumping Act could be invoked by the cast-iron soil pipe interpretation. This broadening of the scope of the law is most serious. It is additionally serious because unlike escape-clause actions, the President is given no authority to override such a Tariff Commission finding in the broader national interest.

It should be noted further that the mere setting in motion of the investigatory machinery, which has occurred 165 times since 1934, generally prevents all imports in the category under study from clearing customs. All appraisals cease, and the cloud of possible retroactive penalties hangs over trade. This suggests the door is open to a dangerous tactical diversionary effort by domestic producers even in cases where they do not expect to have a finding favorable to their case.

(*j*) *There is a valid argument in favor of trade restrictions to aid national defense, but the case requires careful qualification.* The nature of total war requires that we pay more attention in peacetime to potential war needs than ever before. To wait until war strikes us would be too late to make plans for our industrial defense. But this necessity does not automatically sanction every claim offered by industries or Government bureaus that defense needs conceived in any narrow sense should override all other considerations. Such a course could negate the effectiveness of the free market system of directing production. There is already a tendency for some secondary industries to wrap themselves in the flag and to try to join the group of industries really vital to defense.

It is also evident that much greater study is required of the very concept of the mobilization base. There is question whether the present tests of defense essentiality reflect realistically the changing nature of war. If nuclear war comes, the suddenness of attack and the widespread destruction of industry both may militate against any orderly conversion of industry in accord with a previous plan. Only weapons in being, and a high level of skills and adaptability with wide dispersion of industry would offer much help.

There is also the danger in accepting the "fortress America" idea of neglecting the importance to our own safety of having strong allies. We could not survive in a world in which we had to "go it alone". Allied strength requires that they be encouraged both to manufacture weapons to free them from dependence on uncertain sea communications, and that they be as strong as possible economically in peacetime, so that they can withstand the many economic and psychological weapons of the Communist arsenal. This economic strength requires access to foreign markets and close ties with other free world countries so that they can share in common progress without the threat of being picked off one by one by the Soviet empire. Nor should we minimize the importance of the spur of competition both from home and foreign industries and the retention of mobility and adaptability in our economic system as aids to our defense.

Differences of opinion among witnesses make clear that further study of these problems is required in the light of new conditions. There are legitimate defense needs, and these should be met. But tariffs or quotas may be very poor ways to solve these problems. Explicit subsidization of the industries concerned may be cheaper and offer a clearer understanding of the costs involved. Perhaps, also, more study should be made of the reasons certain industries essential to defense are unable to withstand foreign competition, and an effort made to cure as many of these situations as possible.

(*k*) *Several methods are available to ease the short-run adjustment problem of industries affected by foreign competition.* Basic is that depressed industries should be encouraged to solve their problems rather than to be carried along with palliatives or that trade be restricted. There are proposals that depressed industries be given loan assistance, special tax benefits, and encouraged to switch to the manufacture of exports. It has also been proposed that their employees be given special unemployment compensation, or might be aided with counsel on employment, new job training, earlier retirement, and moving expenses to new locations. Two points might be made. There is no reason for limiting aid to injuries caused solely

by imports if there is a case at all for such aid. Secondly, aid should concentrate on hurt individuals, whether they are workers or businessmen. Broad aid to whole industries, without regard to the condition of the separate firms, seems neither required by equity nor economical.

(*l*) *Without passing judgment on domestic agricultural policy, we nonetheless recognize that our trade policy will be made more difficult so long as we have substantial agricultural surpluses and some prices held above the world market level.* Such policies either take foreign markets from us as lower priced sources expand their production, or we are faced with the charge of dumping abroad with its danger of counteraction and reprisal. Artificially propped prices at home also require quota restrictions against imports, a control contrary to the objectives of trade policy. Although a limited outlet, selected surplus foods can properly be used for humanitarian relief and to free labor in developing countries to build social-overhead investments, including roads, schools, and hospitals. But such measures are only a minor part of the complete solution to the surplus problem and often have secondary effects which are undesirable. Continued efforts should be made to develop a domestic agricultural policy which can be reconciled with our foreign economic policy.

(*m*) *The Buy American Act has little place in our trade policies; it should be repealed.* Government purchases are too large and important to be taken out of the context of having to meet the test of market efficiency. Such associated problems as those of depressed areas and defense essentiality should be met by other solutions. There is too great a danger that favoritism, arbitrary decision, and reprisal will be invited by continued use of Buy American Act.

One of the most striking abuses of the Buy American Act has been certain rejections of foreign bids made to supply electrical generating equipment for various Federal power-dam projects. The hazards which foreign bidders have faced have been many, and the rejections of their bids have created an added burden for the American taxpayer as well as creating ill-will abroad. Often the measures used to exclude foreign bids have been oblique. Specifications have been drawn that are difficult for foreigners to meet, and the claim has been made that foreign low bids do not meet the specifications laid down. Additional administrative rulings have awarded contracts to higher American bidders on the grounds that there is unemployment in the areas where such machinery is produced. Because our policy has wavered, and administrative discretion is so great, undoubtedly some foreign producers have been discouraged from bidding when they feel technicalities will be found to reject their offers.

A case can be made for leaving the specialty work of custom construction to foreign manufacturers of machinery, and allowing our own large machinery and electrical firms to concentrate on mass production where their talents and cost advantages show up best. Freedom of importation of such specialities would help to maintain the export outlets now so important to some of the same domestic producers who complain about competitive imports.

(*n*) *It is evident that no single review can explore all the problems associated with foreign economic policy coordination in the interests of domestic stability and growth.* Further study, however, would help to find better solutions to the many complex and troublesome problems in this field.

Recommendations

1. The President must continue to coordinate the diverse interests represented in the executive branch, and bear responsibility for foreign economic policy within that arm of Government. In the nature of our constitutional practices, there is not the same opportunity in the Congress for centralized coordination of all foreign economic policy, viewed in the broad sense. This puts a special responsibility upon individual members, the party leadership, and the standing committees of the Congress to consider the impact of their legislative proposals and their speeches on both home opinion and foreign behavior.

2. We should keep in mind in greater degree the psychological impact, as well as the purely economic, of domestic decisions which affect our foreign economic relations. We should keep in mind that our day-to-day actions often speak much louder than do pronouncements of overall good intentions, with consequent effect on the attitudes and behavior of friendly nations with whom we must cooperate in our own interest.

3. The United States should continue to champion multilateral trade on a most-favored-nation basis, insisting on reciprocal reductions in tariffs as well as the removal of other trade controls even without special concessions. Our reductions of trade barriers should be the occasion for hard bargaining with other countries to ease trade throughout the free world. The instrumentalities of the General Agreement on Tariffs and Trade, the Organization for Trade Cooperation, the International Monetary Fund, and the International Bank for Reconstruction and Development offer the best immediate opportunities for multilateral negotiation to make the greatest progress possible.

4. The United States should approve the agreement calling for its membership and participation in the Organization for Trade Cooperation.

5. The United States should continue to press for the earliest resumption of currency convertibility consistent with finding stable and maintainable rates. Our interest in such convertibility is to minimize trade discrimination and to spur international investment. It would be our hope that in particular the countries of Western Europe and the sterling area could meet the necessary conditions for de jure convertibility before too long. Although such convertibility should not be forced prematurely, neither should it be consigned to the indefinite future.

6. Tariff and trade policy of the United States should be dictated by the national interest, rather than in terms of specific industries or products. Where individual industries cannot meet foreign competition, other solutions than new trade barriers should be sought.

7. Further cuts in United States tariffs are in the national interest. The disruptive effect of such reductions can be minimized by making these cuts gradual, selective, reciprocal, and timed to fit the condition of business. Resort to quotas should be allowed only under extreme emergency conditions when other solutions are not available. Further simplification of the customs laws and related administrative matters should be carried out at the earliest possible date to streamline their operation and minimize arbitrary elements.

8. If aid is to be given to distressed areas or industries to meet the problems caused by new imports, such policies should be part of a broader program to meet similar problems of any source, not those of foreign trade alone. Such aid should not be aimed at blanket coverage, but to meet the specific hardships of people actually in distress. Aid should be viewed as temporary, and should be designed to contribute to the permanent correction of the distress so that aid can be terminated. It should not delay the solution of uneconomic arrangements which would continue to drag down the rest of the economy indefinitely.

9. No basic change in our controls on trade with the Communist countries is required at the present time. Trade in strategic goods would not be in the interest of the free world. But peaceful trade is not excluded from the realm of possibility any time that it is in the interest of the free world. Because East-West trade policy requires the cooperation of all countries of the free world, our policies must be coordinated with theirs. If we would limit trade important to our allies with the Communist countries, this policy carries a responsibility to provide alternate markets for their trade.

10. International investment and technical aid, both public and private, need further encouragement. Each case requires individual study and the solutions should be tailored to fit the circumstances. It should be kept in mind that this aid and investment is more than purely economic in character, and this will influence the choices made. Although broader considerations are involved, such aid, whether loans or grants, represents the positive and long-term equivalent of the negative and short-term restrictions on trade with the Communist bloc. This is a time when the Communists are using our own aid devices to further their ends, and we must be prepared to meet this challenge with a coordinated program which combines all the aspects of countering the problems created by the Communists. Only thus will the free world hold its margin of strength over the Sino-Soviet bloc.

11. Further study of domestic agricultural policy should take into account in greater degree the foreign economic policy aspects of these domestic measures.

12. Further study is required of the whole concept of defense essentiality if it is not to dominate over other necessary factors in trade policy. Not only should impartial criteria be discovered, but the whole concept of the mobilization base in the light of evolving military strategy should be reviewed.

13. New criteria should be developed to restrict application of the escape clause and peril points to industries where failure to apply these provisions would result in real hardship to individuals, whether workers or businessmen.

14. The problem of interpretation of antidumping penalties is a complicated one which deserves careful study rather than precipitate action; the need for change is recognized as its interpretation threatens to negate our foreign economic policy goals, but the remedies must be sought only with thorough investigation. At the very least, the President should be given authority to override Tariff Commission decisions when the national interest requires this.

15. We should give added encouragement to the preparation of international statistics, with attention both to the breadth of coverage and the quality of the information; data on national income and its distribution are particularly needed.

16. We need more study of what makes for economic growth both at home and abroad, if we are to choose policies which promote this development in the interests of attaining our national goals.

17. The work of this subcommittee should be continued for at least another year to explore more thoroughly some of the problems raised this year which were only partially answered. This study should include more specific analyses of individual situations than was possible within the general frame of reference of the current study.

SUPPLEMENTAL VIEWS OF REPRESENTATIVE TALLE

The subcommittee has endeavored diligently to supply a significant contribution to our understanding of the problems of foreign economic policy. Although pressure of other committee assignments prevented me from participating in the hearings, I took part in the planning and organization of the study and am in the process of studying the printed hearings. I am particularly impressed with the need for improved statistical information in this area as was so well documented in the hearings. Trade policy must be viewed primarily from the standpoint of its effects on our industry, agriculture, living standards, and national defense. We must pursue policies that will strengthen our domestic economy and that of the free world. We must be mindful of the adjustments caused by moving toward freer trade. The suggestions offered at the hearings of the subcommittee and in this report bear careful study. Not having participated in the hearings, I do not feel that I am in a position to give my approval or disapproval to the subcommittee's report, but I believe that it should be transmitted to the Congress. I am sure that it will be of interest to the legislative committees, the Congress as a whole, the executive agencies, and the general public.

HENRY O. TALLE.

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